
PRICING BEHAVIOUR & MARKET POWER

CHAIRPERSON: Good morning ladies and gentlemen just one housekeeping, the normal housekeeping rule, just switch off your cellphones and welcome to the MasterCard team. Welcome to Mr. Eddie Grobler, Mr. Caleb Raywood, thank you, Peter Leon, Nkonzo Hlatshwayo and Dario Milo, welcome and I see you have got copies of the slides which you have prepared. We will take those as Exhibit B for purposes for our record.

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ADV PETERSEN: Triple B...

MS NYASULU: Triple...

CHAIRPERSON: Sorry triple B. We have already gone passed double B, right you can then proceed. This is a follow-up upon the previous presentation you made. I cannot remember what was the date and we said if you..., because you could not finish we are going to try and arrange for another date so this is..., I suppose this is the follow-up to that presentation?

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MR RAYWOOD: Very much so Mr. Chairman, yes...

CHAIRPERSON: There were a couple of other presentations, which were outstanding. I cannot remember I mean they were but today was allocated. It was the day when you are going to finish those off.

MR RAYWOOD: Yes that is correct.

CHAIRPERSON: Okay.

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MR RAYWOOD: This is not..., find there are seven face to face meetings with either the Enquiry or the technical team and over the course of those meetings supplemented by a vast amount of written submissions we have explored an array of issues around payment card and interchange and for us the purpose of today was not simply to reiterate only if the information been put before you at all but really to pickup on the dialogue that the Enquiry has lead with the banks subsequent to the last occasion on which we were here so to the extent that they have been available, we

20 have been following the transcripts. We have had people here and we followed the dialogue with great interest. So today I am thanking you for introducing the team,

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you have Eddie Grobler, I am surrounded by personal (indistinct) of partners from Webber Wentzel.

We felt we would try and continue that dialogue as best we can and also we felt that in a way we have come full circle and particularly with Webber Wentzel here, we might explore the Competition Act again which of course is our initial point of departure. I look at the potential impact of the Competition Act on interchange. So with that said, if I may (indistinct) what Victor Nkonzo just to take us through the first slides and then we will take it from there.

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MR HLATSHWAYO: Good morning Chairperson and...

CHAIRPERSON: Before you proceed Mr. Hlatshwayo, will this be the slides we had on top of the table?

MR RAYWOOD: Exactly sir, we are not intended to repeat the presentations that we did not make last time, we would rather sort of take the discussion on a few steps.

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CHAIRPERSON: Alright, thank you that is..., you may proceed then Mr. Hlatshwayo.

MR HLATSHWAYO: Thank you Chairperson, we, I am just afraid that this is going to be a very short presentation. We are going to deal with Section 4(1)(b) insofar as it relates to the MasterCard scheme and the setting of interchange. We will deal with the issue of whether or not Section 4(1)(b) is actually applicable to the most of that scheme.

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We would also deal with the concept of the..., of a legitimate transaction insofar as it relates to Section 4(1)(b). We will deal with the importance of characterising interchange hence the possibility of looking at defence of interchange. We will then deal with some policy issues in relation to the regulation of interchange. We will contrast this with the Australian experience. We will look at the potential risk of a..., in regulation. If I then may turn to Section 4(1)(b) directly, one of the most important requirements of Section 4(1)(b) is that the parties in question must be in a horizontal relationship. That is indeed the starting point, there must be comparatives.

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The critical question to raise here is whether MasterCard is in fact in a horizontal relationship with the banks. I think the very simple answer is that it is not. It is actually in a vertical relationship. This arises from the mental question on whether or not it is appropriate to look at the interchange scheme, the MasterCard interchange scheme in the context of Section 4(1)(b) given the fact that MasterCard is not in a horizontal relationship with the banks.

10 It is also important to appreciate that MasterCard is not actually an association of the banks. In other words the banks do not meet through the instrument knowledge of MasterCard in order to set interchange fees. You will recall Chairperson that we, I think we indicated in our previous submissions that MasterCard went through the IPO last year and in terms of that, public shareholders hold 83% of MasterCard voting shares.

20 None of the financial institutions hold any Class A shares, which get voting powers, consequently the banks now have no influence to not sit in the Board that determines interchange fees. This is vastly different from I think the Visa arrangement where

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there is a Board in which the brands have to be presented and which they may participate in the decision for the setting of interchange fees.

So given that scenario, I think we are unable to understand how Section 4(1)(b) would be applicable to the MasterCard scheme. So the short answer there I have given to that question is simply that Section 4(1)(b) is not applicable. We have not dealt with Section 4(1)(a) which also requires that the parties be in a horizontal relationship but within that it follows that both as for Subsection 4 are not obligated
10 to the MasterCard scheme. That is the short presentation I wanted to make Mr. Chairman.

MR MILO: If..., Mr. Chairman if I can then take you through the next two slides...

CHAIRPERSON: Right.

MR MILO: This is the additional argument or if you like an alternative argument which MasterCard regards as available to it and that is that if one assumes that the
20 threshold requirements of Section 4(1)(b) are met even on that assumption Section 4(1)(b) is not violated by the MasterCard scheme. And this is an argument that you

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familiar with, we know that it has been presented to you before and we dealt with it extensively in our written submissions and the point is that properly characterised, we submit that the MasterCard scheme is a legitimate joint venture.

10 Further and flowing from that we have made the argument that interchange and setting the default interchange fee, is a coactivity of that joint venture and in fact to simply quote from our first submission at page 71 which followed on our detailed economic analysis, we submit that interchange is a necessary and indispensable part for the operation of the four party scheme. The legal context in which we make this alternative or this additional argument Mr. Chairman is the ANSAC case and we submit that the ANSAC case provides the point of departure for the introduction into South African Law of the legitimate joint venture doctrine or the legitimate joint venture argument.

20 We see ANSAC as providing the springboard for the development of this doctrine in appropriate circumstances and what we reproduce here rather than taking you in detail through ANSAC, is what we regard as the heart of ANSAC in those context

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and that is at paragraph 49 of the decision where the Supreme Court of Appeal made it clear that one has to contra..., one has to contrast price fixing schemes which the Competition Act rightly regards as inimical to competition law in South Africa with an example used by the Supreme Court of Appeal, legitimate *bona fide* joint ventures that generate pro-competitive effects.

10 And we also would refer you here to paragraph 54 of the ANSAC judgement where much the same point is made by the Supreme Court of Appeal and therefore what ANSAC councils just before we move on to the next slide is that one must..., before one gets into 4(1)(b) interrogate an interior inquiry and the interior inquiry is to properly characterise the agreement or the arrangement that is before the..., any competition authority. And it is in the context of this characterising approach as opposed to a literal approach to Section 4(1)(b) where the..., that the ANSAC court refers approvingly to United States jurisprudence and in particular refers to the BMI case which is effectively the *locus classicus* for the joint ventured docs and in US
20 law.

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And we therefore say and this is taken us through to the next slide that it is appropriate to consider that invitation to examine United States jurisprudence in this context. There is a rich jurisprudence on joint venture law. We have referred in our second submission in particular at paragraph 9 which is page 36, to how we use United State's jurisprudence in support of our arguments.

10 And we do not want to dwell on it any further here accept to point out that the NOBANCO case which we regard as being on all force with the MasterCard scheme is a case that we think articulates the issues properly and clearly.

In fact we regard NOBANCO as being..., we regard should I say the MasterCard scheme as being a (indistinct) case when one looks at NOBANCO because of the IPO considerations which Nkonzo mentioned earlier and if one then looks at NOBANCO, the importance of the judgment if we can simply highlight two important factors that the Court of Appeal considered.

20 The first is that it has adopted the District Court's rejection of a *personae* approach and it said in that regard that it was inappropriate to regard the Visa scheme as a

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personae violation of the Sherman Act. It was not plainly anticompetitive, it did not lack redeeming virtues, you know one only labels conduct or agreement as *personae* violations if courts have considerable experience with the industry concerned and so on and so forth.

10 And that is the first important point we extract from the NOBANCO decision. The second one and it is one that we want to emphasise is that the District Court in NOBANCO having heard nine weeks.. from the case it appears, nine weeks of testimony and gone through as it says thousands of pages of exhibits, reached the conclusion that on the rule of reason approach which was the approach that the court said should be adopted, the Visa scheme passed muster under the Sherman Act and did not violate Section 1 of the Sherman Act.

20 And we would refer you in this regard in particular to para..., to pages 1256 through 1263 of the District Court's decision but all of that was adopted in any event by the Court of Appeal in its decision and it ruled, if I can simply quote by way of conclusion of the slide, the Court of Appeal said that the interchange fee yields pro-

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competitive efficiencies that its members could not create acting alone, helps create a product that its members could not produce singly and it supported the District Court's analysis of the rule of reason which it said was based on substantial and persuasive evidence. And so that is how we would..., point we would like to extract in particular from the NOBANCO case.

10 So by way of conclusion of these two slides, we say that on this additional argument which is strictly unnecessary for us to engage in because of the arguments that Nkondo has made but in any event we say that the legitimate joint venture argument avails MasterCard. It is not a..., should not be regarded as a *personae* violation of the Competition Act.

It qualifies as a legitimate joint venture and interchange given the evidence that we have put before you, the economic analyses is clearly integral and necessary to that joint venture and to the operation of the four party systems, thank you.

20 MR LEON: Yes Mr. Chairman I am going to deal with the next slide but before I do so, I just want to draw your attention through initially we have raised before and that

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is the fact that we have an advisory opinion from the Competition Commission which support my completely accepted here at large to make whatever recommendations you like to the Commissioner but they accepts the proposition that on the issue of Section 4(1)(b), we are not in horizontal relationship with the banks.

10 And you might recall Mr. Chairman that we went through a seven month engagement with the Commission or almost a particular issue in 2005 before the IPO took place in May 2006 which Nkonzo referred to and the Commission's conclusion in October 2005 based on the information we gave them then was that the multilateral interchange fee does not seem to result and I am quoting "in the contravention of the *personae* provisions that form a price fixing."

20 This previous to indicate and issued advisory opinion is what it happened is the Commission gave us an initial advisory opinion which we then responded to and pointed certain things out to the Commission and they then responded by way of this advisory opinion. So even back in 2005, the Commission was of the view at that time that there was not a 4(1)(b) contravention on this particular case. I just think it is just

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important to make that point. It is in our written submission but I just wanted to emphasise it.

CHAIRPERSON: Yes we are aware of the advisory opinion (indistinct).

MR LEON: Thank you.

CHAIRPERSON: We are aware of that.

10 MR LEON: Yes.

CHAIRPERSON: As you write your point out who at large we got a recommendation at the end of the day because it was in that advisory opinion but...

MR LEON: Yes...

CHAIRPERSON: Yes, you can carry on with your...

20 MR LEON: Yes but Chairman just touching on this issue by the characterised interchange, I mean Dario has dealt with the obvious effect of the..., as we see it, the help for effect of the US judgments in particular the decision in the NOBANCO case

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but we would say there are two things here just looking perhaps at the 4(1)(b) type of approach that you cannot have interchange, you cannot have a four party system operating without interchange, that was our first submission.

10 The second one is that even take into account the interchange methodology which we are looking at that it actually has pro-competitive effects. We say that for a number of reasons. One is that it can promote competition amongst issuers and amongst acquirers. Secondly it optimises these, I think it is a very important point of it, optimises the issuing and the acceptance of cards, the whole issue of interoperability and then obviously I think very important point from the Competition Law perspective, is that we have argued that these had increased the market for electronic payments. It brings about, it promotes, associate economic welfare which is one of the requirements mentioned in the Competition Act.

20 Chairman, the last slide I just want to deal with is..., what we would submit and an extremely important one because it raises some of the issues that are recently been looked at from a great deal of detail by the Competition Tribunal in the Mittal Steel

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case where you recall that there was an upheld complaint of excessive pricing by Harmony Getz Mittal and we would say there are a couple of things, very important points that come out of that decision which we draw attention to at the bottom of this slide that I mean all the points we raise here in a sense are addressed in Mittal.

10 And the first one is that the Tribunal has said very (indistinct) that it is not the province of a competition regulator to be a price regulator and you recall from the judgment of the Tribunal with that particular case that they go into great deal of detail as to why that is not the province of the competition regulator that is really a province of a specialist price regulator like ICASA, which deals with telecommunications and Chairman I just draw your attention because it is not now a written submission that paragraph 73, 74 and 75 of the Mittal Steel case on page 25, we think are extremely important. If I can just...

CHAIRPERSON: Can you give me those paragraphs again Mister, I am sorry...

20 MR LEON: Paragraph 73...

CHAIRPERSON: 73...

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MR LEON: 74 and 75, page 25 of the decision. The Tribunal makes the following points. The first is that..., the first point they make in paragraph 73 is the transcript the competition regulator does not extend to determination and fixing of prices.

The second point they make in paragraph 74 is the price determination is best left to the interplay or independent act as engaging with each other in the market place. The fundamental task in competition regulators is then to promote and defend competitive market structures and to guard against conduct on the part of multiple participants which seems to undermine the promise of those competitive structures to deliver methodology influence and services in competitive prices.

I think the most important point they make in paragraph 75 is that the principle function of competition forces is to guard against exclusory conduct that is unilateral conduct predominant firm that has a subjective to reproduction of this dominance through the exclusion of actual or would be competitors from the market.

And that is how the Tribunal goes into the whole discussion that it does about excessive pricing in relation to what they describe as “super dominant firms,” which

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is a particular type of dominance where all forms of competition seemed to be excluded. And Chairman really the point we are making here is twofold. The one is when one looks, we would submit, when one looks at Section 4, one must be looking at issues of structure.

10 When one looks at Section 8 which is obviously abuses of dominance, one can then look at issues related to excessive pricing but looking at those issues of excessive pricing one in accordance to the Tribunal, only looking at firms which are super dominant and all the learning that comes in there and therefore we would make two points. The one is that we are..., when one is looking at Section 4, one should not appropriately look at the level of interchange.

20 One is going to look at the level of interchange, we would submit there would to have be an inquiry under Section 8 and we say that that is supported by the very extensive judgment of the Tribunal in Mittal Steel. And that Chairman brings me on to the issue of Australia which come a bullet risk.

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MR RAYWOOD: Thank you very much Peter and perhaps this slide is in our minds is Peter I think is very adequately explained is the we are looking over the fence. We are looking into policy considerations and as we say our submission is to that is..., this..., if you like water still the competition regulator should not go but we are very conscious that in terms of this inquiry extends to policy recommendations. So it is without a mind that we are looking at comparing South Africa against our mutual foes in Australia. We pick Australia because obviously there is a bank there that has

10 been worn most aggressively targeting an interchange.

We greasily have put some figures up with that can a European country role of Europe but I particularly like to concentrate on the party issues and unique characteristics of South Africa which a policy regulator would have to consider before taking any particular stance intervening in the setting of interchange. And really perhaps the..., in this table which is taken from the Euro monitoring reports, the first line of interest is the financial cards in that third line of the table and we look

20 that for Australia and financial cards is the total number of cards, credit, debit, ATM, store cards.

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There are 39 million cards for a population of just over 20 million. So those are almost two cards per person and compare that with 31 and half million cards in South Africa for a population over twice the size. So you have two and a half times as many cards per person in Australia than in South Africa and if we look particular on the issuing side, look at the bank accounts that we have here.

10 Over 26 million bank accounts of which a debit card would be associated so it is more than one per person in Australia suggesting a very saturated issuing environment (indistinct) which the South Africa side and we are 18 million accounts short. So it is clearly a huge gap on the issuing side moving to credit cards, again almost one per person in Australia as against one for every people in South Africa.

And in Australia credit cards accounts for 50% of the total number of cards in South Africa it works out at 23% of all cards. So I would suggest that these figures indicate that South Africa is issuing is not one of the less over use of credit or credit card being used at the expense of another system and these were the policy drivers the

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Reserve Bank of Australia note the Reserve Bank not a competition regulator to come aBoard when he decided to intervene and the setting of interchange.

And we would suggest that the far more transparent concern for South Africa is to address the large on bank population and very little card usage. As Mr. Monsen explain when he was last here representing MasterCard, it is one thing to get the price stick in the hands of cardholders, it is quite another to get them to use it and they are the principle challenges that we face as a four party system.

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So I have suggested that there is a very big gap on the issuing cardholder maxis. If we look across of the acceptance, the merchants is the final line on that table, it is the number of POS terminals. South Africa is not doing too badly at all and indeed this seems to illustrate the points we previously made that on the acceptance side of the business, some 90% of merchants or volume are in within the system. It might seem to illustrate a very high degree of penetration on the acceptance side contrast the position on the issuing side.

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ADV PETERSEN: So we have suggested the leverage...

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MR RAYWOOD: I...

ADV PETERSEN: Excuse me for..., when you say by volume, volume of what?

MR RAYWOOD: I think in terms of GDV, in terms of the volume of transactions...

ADV PETERSEN: 100% of merchants by volume.

MR RAYWOOD: By...

10 ADV PETERSEN: Number of merchants or...

MR RAYWOOD: Rand volume.

ADV PETERSEN: Rand volume?

MR RAYWOOD: Yes I think that has to be correct.

(Caucus)

MR RAYWOOD: Oh Mr. Grobler is telling me both.

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ADV PETERSEN: Thank you.

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CHAIRPERSON: Oh you may proceed Mr. Caleb...

MR RAYWOOD: So I am not going to go back into the detail of interchange balancing demand, I think you have heard enough about that but when you are looking at the issuer and acquiring side, we suggest that in South Africa for a policy maker, the issuer really needs to focus on the issuing side of the business and we would suggest that if there was a drive to lower interchange all that can do is higher the price for cardholders thereby making that gap even more unbridgeable.

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Just moving on to a couple of points on the interchange methodology, we say that merchants know what they are paying if they care to find out and they can find our interchange rates. There is a lot of concern with the interchange rate is not transparent, it is not visible to merchants and we just disagree with that entirely. However what we have decided to deal, we can tell you today is that when MasterCard take several of setting of interchange rates in South Africa which will be later this year, we will publish what those interchange rates are so there can be no question that there is a lack of transparency to those rates. When we do take over the setting of

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interchange rate be the structure that we intent to place in the initial phase is to have one rate for credit cards, one rate for debit cards and one rate for hybrid cards which is similar to the structure that we have at the moment and really Mr. Chairman not recognises the..., if you like transitional phase that we are going through in South Africa with a long history of..., remember the bank setting interchange rates and now moving to MasterCard setting those rates.

10 So we see the first step of that process is for us to takeover the setting of the rate as they arrive now however as we previously explained on methodology, is flexible enough to accommodate different merchant categories, transactions criteria and card product and you heard quite a bit from Visa about this certainly since yesterday. Mr. Chairman the next slide is on potential risks of regulation and this is a slide you have seen before, Mr. Monsen spoke some length about this the last time we were here.

20 And I do not propose to go through this in any great detail. I have been to say that they really are not the risks that a policy regulator would have to address now before in to dealing in the interchange, it is so easy to upset the upper card in terms of

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favouring one four party scheme against another three party schemes against four party schemes, large player schemes, small players and discouraging investment in innovation that is the final bullet point there.

10 And from a potential to the actual, we say that the regulatory favours are very evident in Australia. There is a more expensive payment system which delivers few benefits to cardholders, distorts market competition, suppresses technologically innovation and allows large merchants to then join their monopoly market power to take advantage of decisions, situation relations to their customers. Our final slide and sir is our conclusion which really raps up everything we have said today and we make the point that the MasterCard scheme does not fall within Section 4(1)(b) and that is logically because of our singly (indistinct). We have a different structure to Visa albeit Visa has announced just going through a clearer route and following MasterCard down that path.

20 MasterCard is therefore in a vertical relationship with our banks. It is a legitimate joined venture and interchange is absolute view of the court that a legitimate joined

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venture. So we set the level of interchange which is something that has come up before is very much outside the skirt of a Section 4 inquiry for competition regulatory comes in Section 8 otherwise it is for another regulator to address and the regulation of interchange itself carries very significant risks and with that Mr. Chairman we are available for any question you may have.

CHAIRPERSON: Thank you.

10 MS NYASULU: I just want to ask one question for now just so that I understand where you are coming from with your governance structure because you have put great emphasises not only hear but in close meetings on the fact that you are..., that you have a different governance structure. What is the significant of that to this debate?

MR RAYWOOD: Certainly, I think the position was that prior to our IPO, MasterCard was owned by the banks which issue cards and acquire MasterCard transactions and the accusation that was levelled at MasterCard was that we were
20 therefore in a horizontal plain with the banks and what MasterCard did was really of

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the directions that the banks who owned MasterCard. We feel we have extremely robust defences to that argument except it was not born out on practice however the IPO really puts that argument to rest entirely or banks do not play any role in the governance of MasterCard whatsoever.

10 A Board of Directors are independent of the banks and our shares or the acuity in our banks well 4(1)% is owned by the banks so there are no voting lines associated with those shares other than for particular what we call "Class M" issues. So the date today governance and voting rights associated with the shares is with the Class A, the publicly held shares and the shares held by the MasterCard Foundation. So we are saying to the IPO has effective putting beyond doubt any argument that MasterCard is in a horizontal plain with the banks on issue and acquire MasterCard transaction and no Section 4 is applicable.

20 MS NYASULU: Can I just follow that up just to understand the governance structure because it is one thing to have a Board of Directors that is totally independent and to have shares which cannot be voted by your customers but we all

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know that customers can exert influence in different ways. As I understand it, MasterCard only has one set of customers and those would be the banks.

MR RAYWOOD: That is typically how we look at it. We do not have for example conference with merchants or with shareholders. Our contract from a legal relationship is with the banks and we licence them to use our brands. So we had a discussion about whether it is banks or financial institutions, I do not think that is particularly relevant but you are correct and that is where our main relationships lie.

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MS NYASULU: And so what would happen as crazy as it sounds because obviously you know banks are as reliant on you as you are reliant on them but what would happen for instance if all the banks for whatever reason forget that they can vote and they do not sit on your Board but they have tremendous influence by virtue of concentration risk, if you like, if they all decided that they were moving to Visa instead of MasterCard.

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MR RAYWOOD: I think we will all be out of jobs but I think that is one of the healthy facets of the competition that we have at the moment that it is a very dynamic

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environment and MasterCard and Visa are very aggressive competitors with each other.

MS NYASULU: Okay all I was trying to demonstrate is you know influence does not necessarily only sit in the governance structure and the Board of Directors that by virtue of being dominant customers they could exert some significant influence on...

MR RAYWOOD: Absolute it certainly is the case and we have some very large
10 banks and very significant shareholdings in MasterCard. Equally that the point was made very forcefully by Mr. Mosen, we are now listed on the New York Stock Exchange. We are subject to SCC governance issues and if our Board of Directors start to taking decisions for the benefit of some customers rather than for MasterCard, we would sack that Board of Directors immediately.

MS NYASULU: Thank you.

MR BODIBE: Good morning Mr. Grobler and your team, I just have a few
20 questions. Can you explain to me why you believe you are a joined venture? What is the structure of that joined venture?

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MR MILO: Perhaps I can start to deal with that question and that is..., well effectively and we want to have besides of cause that this is our additional argument as opposed to our primary argument which is that Section 4 is not applicable but I think that perhaps the way to approach these if I can refer you to our first submission that pages 50 and 51, 50 to 51 and following and that is where we indicate the nature of the joined demand of cardholders and merchants and the joined production by the banks issuer and brand acquirers. And it is this cooperation enabling nature of the

10 four party system that is I suppose an important characteristic of its joined venture nature. These factors incidentally were all referred to approvingly by the NOBANCO decision both the District Court and the Court of Appeals. They made the point that although this may not look like a classic jointed venture where you have intermingling of assets, sharing of profits and losses et cetera, the thrust of it being characterised by joined demand and joined production means that the same kinds of considerations can take place and are applicable.

20 MR RAYWOOD: Just one point and that is simply to add that the joined venture is greater than some of its parts, no one bank can replicate the MasterCard scheme or

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for that matter the Visa scheme. It is very unlike the same degree as all the banks acting in cooperation to provide this joined ventures arrangement.

MR BODIBE: So in reality you are extremely, the concept of joined venture as opposed to suggesting that your structure is a joined venture?

MR RAYWOOD: There are some (indistinct) just a legal joined venture with partnership agreements or anything like that. It is an economic joined venture.

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MR BODIBE: So it is not only dealt an economy joined venture.

MR RAYWOOD: Correct.

MR BODIBE: And the structure of that joined venture, can you explain it to me? The structure, so what is your relationship with the banks well are they members, are they shareholders and in which case what is their power.

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MR RAYWOOD: Okay and perhaps I can just look at the position after the IPO rather than the harsh what had happened before the IPO. The banks who issued an acquirer transaction hold Class B shares in MasterCard and that currently constitutes

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4(1)% of the entire shareholding of MasterCard, 10% of our shareholding Class M shares is held by the MasterCard Foundation and 49% is floatable on the New York Stock Exchange. Class A shares and Class B shares carries different voting lines. Class B shares carry no voting lines. Finance Institutions hold a Class M share and that is a device for certain very large issues be on the day-to-day operations of the company. So if the Board wanted to go into space exploration, the banks would use their Class M shares to veto that sort of complete change in the business of MasterCard. Other than that they have no day-to-day control through their shares. The other part of your question is the relationship between MasterCard and the...

ADV PETERSEN: Excuse me if I may just ask you to clarify something before you move on. Would I be right in thinking that in the change from the old structure to the new structure as perhaps any demutualization, the initial holding of the shares which were floated would have been by the previous members?

MR RAYWOOD: There was certainly a phase where the banks had to sell 59% of their shareholdings that they diluted their ownership of MasterCard from a 100%

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down to 4(1)% and they were remunerated for that. That is correct so the other aspect is the licensing arrangement and MasterCard licences its customer banks if I mention institutions to use the brands in particular MasterCard, Maestro and CIROS. Now I think here there is a distinction, it might be helpful to make between MasterCard and Visa and through reading the FNB transcript I understand that the way Visa is structured is it issues acquiring licences and issuing licences and they will only issue a bank an acquiring licence if the bank already holds a 15% market share on the issuing side. MasterCard does not have the same structure. Our licences go with the brand not with the activity.

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MR BODIBE: Okay thank you for thank now and the MasterCard Foundation, who does it represents?

MR RAYWOOD: The MasterCard Foundation is entirely independent of MasterCard to the degree that the MasterCard do not even choose the Directors to run that foundation, it shows people to find the people to run the foundation. It is a charitable venture established in Canada and it will invest in Micro Finance and

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youth entrepreneurship. There is two charge of objectives entire separate to MasterCard or be that of a shareholder.

MR BODIBE: Thank you, so as a bank to have a licence from MasterCard, it is not a requirement that you be a shareholder?

MR RAYWOOD: Well no is the short answer to that as a result of being a customer financial institution you aught to get a Class M shareholding but you..., the volume of shares is calculated by reference to the volume of business you do with MasterCard.

MR BODIBE: So subsequent getting a licence, you get shares?

MR RAYWOOD: Only this Class M share which has no acuity rights associated with them.

MR BODIBE: Okay.

20 MR RAYWOOD: So no you do not get shares just by joining the scheme.

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MR BODIBE: Can we go to your slide on page 7?

(Caucus)

MR RAYWOOD: Sorry I neglected to...

MS NYASULU: Sorry I just needed to pickup something because you said something about the Class M shares that triggered something.

10 MR RAYWOOD: The Class...

MS NYASULU: It does sound like there are certain reserved matters for which the banks could use their Class M shares to veto things. Now the logical question would be for me to ask what those reserve matters are and just to ensure that there is nothing in there that then gives the banks power which the other shareholders would not have.

MR RAYWOOD: Certainly perhaps it is something I can provide you in writing...

20 MS NYASULU: Okay...

MR RAYWOOD: Because these are...

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MS NYASULU: Under confidential...

MR RAYWOOD: It is not confidential...

MS NYASULU: It is not...

MR RAYWOOD: I will make it available...

MS NYASULU: Okay because I would really appreciate that.

10 MR RAYWOOD: The bottom line is the Class M is intended to prevent MasterCard going into a completely different direction from the payment card business in exploring some totally different avenue...

MS NYASULU: Yes...

MR RAYWOOD: Formula 1 racing or something like that...

MS NYASULU: Sure.

20 MR RAYWOOD: So we can provide or bring the...

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MS NYASULU: Please I would appreciate that. Thank you.

MR BODIBE: Okay I think it is the concluding slide.

MR RAYWOOD: The concluding slide?

MR BODIBE: Yes, the second from last bullet. If the level of interchange is concept of the Section 4 inquiry, what is your position therefore of these panel probing this question of interchange?

10

MR RAYWOOD: I think the reason we put some of these slides up is because we are very conscious of the terms of reference that the inquiry has or extraordinary broad and you are not limiting yourselves to competition nor is this currently defined now but you are also interested in making policy recommendations perhaps to other regulators within South Africa and what we were thinking to caution with those slide is, before you make this recommendations understand that South Africa has a very unique characteristics which are not replicated in Australia or another of that markets.

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MR BODIBE: What would have been your preferred position? What would have been your preferred position in respect of that particular point and in terms of reference for the (indistinct)?

MR RAYWOOD: We do not really have a preferential position. I think if your terms of reference were limited to examining Competition Laws as they currently is, then we say it is quite simple. The level of interchange can only be analysed under Section 8 that is where your legislature shows to put in the words “excessive price,”
10 not in Section 4.

MR BODIBE: Then what is your position to a questions that says or a position that ultimately argues that interchange as much as it is trying to balance the supply and demand between two sides of the market but it ultimately finds it expression in the prices in the economy and therefore subject to an inquiry as to whether:
it is necessary and; it is not the way it is set does not create anticompetitive outcomes
20 in the economy.

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MR LEON: Well Chairman the answer to that to Mr. Bodibe's question is that we think if you going to go down that route you need to look at Section 8 and then you need..., if that is the case then you..., one of the things you would have to look at according to the Competition Tribunal's decision on Mittal is whether or not we assume to be dominant or with the whole inquiry about excessive pricing. According to the Tribunal's decision which could cause be reversed by the Appeal Court is that that is a jurisdictional fact and you cannot go down that route until there is that

10 finding obviously of the dominance.

MR BODIBE: Thank you, thank you Chairperson.

ADV PETERSEN: Let me take the points up in the..., I think logical order in which you presented them if I may? Starting with Mr. Hlatshwayo that the difficulty with..., that I have in going with you on your point that since there is no horizontal relationship between MasterCard and its now customer banks, Section 4(1)(b) has no application to the issue of interchange itself is as follows and I..., let me put it to you

20 so that you can consider it and comment on that if you wish to do so. Let us accept

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for the moment that there is no horizontal relationship between MasterCard and the banks and that in fact the relationship is vertical and I raise all these points for purposes of discussion. Not indicating a firm conclusion but would you not agree that the banks are in a horizontal relationship with each other?

MR HLATSHWAYO: Yes.

ADV PETERSEN: You would?

10

MR HLATSHWAYO: They most probably in a horizontal relationship, yes.

ADV PETERSEN: So what we would really have to explore then on that assumption would be whether the banks might be contravening Section 4(1)(b) by the relationship between them which is created through the scheme?

MR HLATSHWAYO: I think as we pointed out Mr. Chairman, MasterCard is a very distinct identity to battle for banks when it sets interchange fees it does so in its own name what the banks then do is something else. I think that conclude to the banks.

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ADV PETERSEN: Yes, now let me just anticipate a little bit and say lest it give rise to unnecessary anxiety that I am probing with this issue at all that it may well be that the matter is disposed of satisfactorily through the characterisation of interchange. I am just concerned about this preliminary point as it were for yours because conclusion that one might come to in this particular set of facts to the extent that it is based upon general reasoning and general principles as to be capable in the application to a variety of sets of facts. So what I want to raise with you without
10 asserting or alleging that this is in fact the case, what I want to raise with you at the conceptual level here is the question of what are called “hub and spoke” arrangements.

MR HLATSHWAYO: Correct.

ADV PETERSEN: And if you will allow me just to clarify for a minute what it is that I am talking about so that you can address it. If you draw on a piece of paper the rim of a wheel, it..., with a dotted line and you place around that rim the various
20 banks and you then have at the centre of that circle or wheel a hub and you connect

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the banks to that hub by way of spokes, the concept of the hub and spoke arrangement is that the hub does the fixing and the banks or the entities positioned along the imaginary rim of the wheel need have no direct communication with each other at all but they achieve indirectly the fixing of the price or whatever it is through the activities of the hub. You know I stress I am not alleging that this is what is going on but this is a structural concept which is very much at the heart of a Section 4(1)(b) analyses. Do you have any difficulty with what I am putting to you so far as
10 a matter of conceptual analyses?

MR RAYWOOD: No that is perfectly valid.

ADV PETERSEN: Right now...

MR HLATSHWAYO: Chairperson I just wanted to point out that the..., I considered the Competition Act to be (indistinct) with structure in the sense that your Section 4(1)(b) which..., Section 4(1) which deals exclusively with horizontal
20 relationships. You also have Section 4 and Section 5 which deals with vertical arrangements and subsequent to that you have Section..., I think eight that gives a

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general point of issues depending on dominance. So unless you fit it into the horizontal space, it is difficult to understand how people who are in a horizontal relationship would be bought into confines of Section 4. You rather be with them in terms of Section 5.

MR HLATSHWAYO: Yes because of that vertical arrangement.

ADV PETERSEN: Yes insofar as there is vertical relationship between MasterCard
10 and its customer banks, interchange may well have to be considered in the abstract I am putting this in concept under Section 5 but insofar as the banks are in a horizontal relationship with each other, does it not fall to be considered under Section 4 as well?

MR HLATSHWAYO: I think we have indicated that Chairperson that banks are in a horizontal relationship in that respect they most probable endeavour the purpose of Section 4.

ADV PETERSEN: And then if one returns to the wheel on the hub and spoke
20 illustration, now consider the hub not being on a flat plain with the rim but being

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elevated above it so that you get a chronicle shape, is there any reason why that should not be a form of hub and spoke arrangement in concept?

MR RAYWOOD: I do feel it is a little bit difficult putting some of these concepts into a vertical or horizontal plain but I have no objection with any of your analyses.

ADV PETERSEN: And indeed Mr. Raywood there need not be other or horizontal nor vertical commercial relationship between the entities on the rim and the agency
10 which performs the fixing at the centre, if that is what is going on.

MR RAYWOOD: I certainly agree it is a valid inquiry for competition regulator to assess fully the role of the hub, is the hub simply a vehicle that is passing information from one bank to another bank and saying “is that okay” and fix the pricing like that or is it as we say MasterCard is a rebuff and independent entity which is then very much in the vertical plain and not in the hub and spoke through banks and setting interchange.

20 ADV PETERSEN: Yes thank you, we have no..., I think we have noted that and we will have to obviously examine that very fully. Now would you further agree that

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what one is concerned with under 4(1)(b)(1) is both direct and indirect methods of fixing a purchase or selling price or any other trading condition. I mean those are the plain wording of the section. I just wanted to raise that single conceptual issue with you to assist us in dealing with your primary contention which is that Section 4(1)(b) has no application whatsoever simply because MasterCard is not in a horizontal relationship with the banks.

10 MR RAYWOOD: No I certainly agree, you have to go half a step further and just to address the relationship between MasterCard and banks and satisfy yourselves as to is that independent or are we simply what is called with the bare compulsory information from one to the other.

ADV PETERSEN: You see once one gets to that point, one wonders whether it really makes any difference that you restructured. It might have been find before and is still find where it might have been not find before and is still not find.

20 MR RAYWOOD: Certainly we have defended interchange on the basis of if you like the old structure aggressively and (indistinct) and we say that it was fine, however

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you will understand we were spending millions of Dollars defending this structure around the world and the route of legal resistance was to find a way of changing the structure that will need then..., leaks down into the system. So putting this argument behind us was one of the principal drivers of the IPO.

10 ADV PETERSEN: Now moving then to characterisation and how one should approach this. As you indicated you have been covering very carefully these hearings but people attending them on many occasions and also studying the transcripts so you will be aware of this questions in this regard which have been raised with..., in particular Standard Bank and Ms Jean Meijer who presented legal argument on behalf of Standard Bank. I do not want to go unnecessarily and bothers you through all the same points but would you agree that our Competition Act has been written in such a way that the simple application of the methodology arising in the United States from the Sherman Act should not simply be uncritically adopted?

20 MR MILO: I will take that Mr. Chairman, I think that the answer to that is that of cause just as in any other area of law, one should never uncritically adopt the

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jurisprudence of another country but having said that the Sherman Act will be it that it was originally and is phrased extremely broadly and exceedingly broadly. Over the years the century or so since its promulgation has been interpreted by presidents, precedence have been created which have narrowed the reach of the Sherman Act and insofar as the narrowing pertains to the legitimate joint venture argument, we regard it as a solid analogy to adopt in South Africa. We certainly do not advocate the lock, stock and barrel importation into our Competition Law of American jurisprudence and as you rightly point out, there are some significant differences when one contrast the governing legislation but in this context particularly where ANSAC and the Supreme Court of Appeal has..., and to put that to its weakest invited that kind of analyses. We regard it as not just appropriate but instructive to look at the US jurisprudence on joint ventured arrangements.

ADV PETERSEN: Just following up on that briefly, in the habit in the United States as you are well aware of distinguishing conceptually between *personae* violations and violations of the Sherman Act which have to be approached through the so-called rule of reason, I just want to ask you briefly whether that is an entirely helpful

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distinction for us to work with when we are wrestling with Section 4(1)(b) of the Competition Act because the more I read on the United States jurisprudence the more I see a recognition of the principle that the interpretation of the Sherman Act always requires reason insofar as it is taken to only prohibit unreasonable restraints of trade. So does the rule of reason apply in general here? It is merely that from a methodological point of view certain conduct is so well recognised as habitually falling into the kind of case that is unreasonably in restraint of competition that the inquiry is a very truncated one. You are nodding Mr. Milo is that...

MR MILO: That is my understanding of the methodology.

ADV PETERSEN: So the so-called *personae* violation is merely a truncated application of the rule of reason?

MR MILO: I am not sure that I would use the term “rule of reasoning” in that context but it certainly a..., I think that some of the jurisprudence has used the word “quick look analyses” and as you rightly say it is to short circuit the full-blown rule

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of reason analyses that one engages in if it is not of a character which is automatically because of experience, prohibited.

ADV PETERSEN: And then as you go along you get because life is complex, you get cases where the quick look is not enough for the characterisation and then you have a somewhat extended look in United States and then you reach a point where you fall headlong into a full what they call “a rule of reason analyses.” Has our section instructed in such a way that that should be our methodology?

10

MR MILO: Mr. Chairman I think that again be..., the way that our section is structured may not necessarily lend itself to the importation of the various spectrum of US approaches in regard to how one views conduct and agreements and arrangements but I do not think it detracts from the point that the ANSAC court was making and that is that where one is faced with a *personae* prohibition and they used that term “*personae* prohibition.”

20

In Section 4(1)(a) one then has to deal with at least evidence that..., whether evidence is admissible for purposes of characterising conduct for purposes of

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Section 4(1)(b), it is instructive in that context to look..., well to pose the question whether a legitimate joined venture falls within Section 4(1)(b) and that itself engages the..., if one looks to the US jurisprudence one then is into the rule of reason analyses for most of the legitimate or for legitimate joined ventures.

10 So we do not want to..., we do not think we need to go so far as to say that we should adopt quick look approach, extended approach but truncated rule of reason, full-blown rule of reason. What we do say is that for purposes of the characterisation approach a equivalent reasoning methodology to that which applies in the US under rule of reason, should apply in South Africa and that is the limit of or that is the highest that we put it for purposes of our proposition.

ADV PETERSEN: I raised it previously and so let me just raise it briefly with you. It looks to me Section 4(1)(a) is deliberately structured so as to call for an analyses of the evaluation of the anticompetitive effects versus the pro-competitive effects if there are any of the conduct. So Section 4(1)(b) presumably is intended to cover
20 something where that kind of exercise is not called for, would that be correct?

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MR LEON: Subject to the warning and ANSAC Mr. Chairman, subject to warning and ANSAC certainly it makes a distinction if we rule of reason 4(1)(a) or 4(1)(b) which is *personae* but I mean the way the Supreme Court of Appeal is interpreted this particular section, it is..., you cannot just say something is *personae* and that is the end of the matter.

ADV PETERSEN: Calls for characterisation?

10 MR LEON: Yes, fine, yes.

ADV PETERSEN: But would you agree that the Supreme Court of Appeal and ANSAC was careful not to be prescriptive about how the characterisation should be performed. They send the matter back to the Competition Tribunal to wrestle with...

MR LEON: Yes...

ADV PETERSEN: So that the whole process could go around again.

20 MR HLATSHWAYO: Chairperson I think there is a fundamental distinction between Section 4(1)(a) and Section 4(1)(b). It lies in the fact that in terms of

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Section 4(1)(a) you have to come to the conclusion first and foremost that the conduct in question or the agreement in question substantially prevents on essence competition. Once that conclusion is reached, you then look at the efficiency claims here that the..., the part is advanced to sort of do the trade of analyses to determine whether or not the output outweigh the anticompetitive effects. So your starting point is to determine whether or not competition is substantially be prevented or lessened.

10

ADV PETERSEN: Specifically with reference to the word “effect?”

MR HLATSHWAYO: Yes those in terms of Section 4(1)(a), Section 4(1)(b) is vastly different in the sense that once you come to the conclusion following the access decision that the conduct in question does fall within Section 4(1)(b), then there is no further inquiry that has to be done but our understanding is that the SA is saying you need to look at the purpose of that agreement. You need to look at the purpose and determine whether or not the purpose was actually to spar for

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competition. If that was the purpose of the agreement then no further inquiry has to be engaged.

ADV PETERSEN: Thank you Mr. Hlatshwayo, you have rescued me. That was the point that I was reaching for. So would you then agree that if conduct could be characterised as having a restrictive purpose and come to insularity in the second that that would be enough to bring it under 4(1)(b)? I am talking about horizontal agreements or concerted practices.

10

MR HLATSHWAYO: That the parties are in a horizontal relationship...

ADV PETERSEN: Yes.

MR HLATSHWAYO: I presume that we sold.

MR LEON: No but Chairman you would have to have regard to requirements before one begin..., it has to be a restrictive purpose and meet anyone of these three requirements...

20

ADV PETERSEN: Yes, yes I am not trying to broaden it with you...

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MR RAYWOOD: Sir...

ADV PETERSEN: On that.

MR RAYWOOD: Sir I might just add..., I mean it sounds extremely attractive to saying look at the restrictive purpose and I think the devil would be in the detail of the amount of evidence that we were required to actually access purpose to the extent you will find yourself into the kind of inquiry that the quick look would have to try
10 and avoid.

ADV PETERSEN: That maybe so in some instances but would you not agree that a blatant cartel arrangement could be condemned on the basis of its obvious purpose?

MR RAYWOOD: If it is blatant, yes.

ADV PETERSEN: And that the characterisation problem which Bloemfontein's Supreme Court of Appeal has forced square and put in front of us that has got to be done with 4(1)(b) that the characterisation may in any event be complex or require
20 complex evidence.

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MR MILO: I think that is right and I think that is the suggestion reading between the lines of the Bloemfontein Court which is that it maybe necessary to go beyond the terms of an agreement if you take the view that the scope of Section 4(1)(b) for example requires a distinction between legitimate joined ventures and to use your example “blatant cartels.”

10 ADV PETERSEN: Yes but you see the difficulty that I grabbling with here which I raised with you earlier is to simply distinguish between *personae* and rule of reason seems to me to miss the task or to inadequately capture the task which has been presented by the legislature in Section 4(1). There is an effect’s test that is 4(1)(a) and there is another test which is 4(1)(b) which requires a characterisation but to call the one *personae* as if it is simple and the other rule of reason is there anything complicated goes in there. I have trouble with that dichotomy and your comment on that would be helpful.

20 MR RAYWOOD: I am certainly happy to comment further and bringing you back into the MasterCard scheme rather than answer Competition Law in South Africa and

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that is to say if you are looking at characterising interchange which is such a core..., it is three core component of the four party scheme if you accept that there is an economic joined venture there and you accept that you need interchange as a vital element of the structure of that joined venture then so far as the assessment of South African Competition Law and MasterCard is concerned, your inquiry is over. To the extent that you need to look at interchange cost of the payment streams where you do not have an entity like MasterCard then you may have further questions that need to be addressed.

10

ADV PETERSEN: And there you would invoke us, I understand it in particular of the NOBANCO case to show that interchange in..., it..., as a mechanism is reasonably necessary to the..., to a four party scheme and should..., can therefore not be condemned as a *personae* violation or in our case if I am right as an arrangement having an anticompetitive purpose.

MR MILO: Yes.

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MR RAYWOOD: That is absolutely the case and of course NOBANCO was looking at a structure similar to MasterCard pre IPO. It is a post IPO where cases even more beyond down.

ADV PETERSEN: Now since you have been..., since you have come with me so far on this particular road, let me then ask you why should the level of interchange not itself be subject to characterisation?

10 MR LEON: We have come in, the answer to that is we say level of interchange starts addressing issues like price, quantity, issues like that and our submission on that that is an inquiry which is related to dominance not to Section 4.

ADV PETERSEN: Well the difficulty I have with that is that you are insisting that my piece of paper must go into one pigeonhole or another and that it cannot go into more than one. If...

20 MR LEON: If I may interrupt, I mean that would be a criticism of the act, you want to put you in once (indistinct) that it is quite rigid in its classifications.

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MR RAYWOOD: It is all a matter and Section 4 is about structure and once you are satisfied with the structure a particular joined venture whatever the arrangement is that is the end of the inquiry. If you are really looking at price which is what level is, is price by another bank and you are looking at your excessive price and the only place the South African legislature to use these words is in Section 8...

CHAIRPERSON: So you say you cannot go to Section 8? Is that what you are saying...

10

MR LEON: No, no we are not saying...

CHAIRPERSON: We have...

MR LEON: No we are saying you can...

CHAIRPERSON: Oh...

MR RAYWOOD: Wish you can but the rules are saying to go to Section 8 you will have to apply the Mittal decision until it is reversed.

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ADV PETERSEN: Is it not a binding effect of the Competition Tribunal's decision Mr. Raywood and as you know it is under appeal and perhaps the less..., oh sorry about that reasoning...

MR RAYWOOD: Well per...

ADV PETERSEN: Better...

10 MR RAYWOOD: Perhaps one point I mean the..., the learning we take from the Mittal Steel is very much in sense of the competition regulator's approach to assessing this and I cannot believe that you approach the Tribunal Turk in saying it is not the role of a competition regulator to be a price maker other than under Section 8, I cannot believe that would..., particular section would be appealed as clearly (indistinct).

20 ADV PETERSEN: But let us accept that as a policy consideration, are we not missing each other somewhat on another dimension here and once again I am raising this in concept and not asserting that the existing level of interchange anywhere in fact should be characterised as having an anticompetitive purpose. I am raising the

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question which is been raised previously with MasterCard in public and with others about the possibility that the interchange mechanism could be used as a platform or a device for manipulating in an unacceptable way. Conditions in the market are either on the issuing or acquiring side and because you have posed your argument in terms of fundamental dividing lines and so on between sections and concepts, I am really having just to put to you that there are subtleties in this issue which speaking for myself I would have to be quite sure that you are right before I would just to close them off even if I was quite happy with the characterisation of interchange as it is currently being conducted. So what I wanted to suggest to you is that if it could be established that the..., a particular interchange arrangement was being used by the participants in it to fix the market, it could be brought under 4(1)(b) theoretically.

MR LEON: Chairman if you need to requirements of 4(1)(b)...

ADV PETERSEN: Yes...

20 MR LEON: Threshold requirements on 4(1)(b)...

MR RAYWOOD: It is still a (indistinct).

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MR LEON: You have to show in this particular case there was some price fixing going on or something to that effect. You cannot just..., I mean that the requirement for Section 4(1)(b) are very, very specific.

ADV PETERSEN: Yes would you care to read it?

MR LEON: Yes Chairman, I mean it says directly or indirectly fixed a purchase or selling price or other trading condition.

10

ADV PETERSEN: Yes.

MR LEON: There has to be a fixing, I mean you used the word I think “manipulate conditions of the market.”

ADV PETERSEN: Yes by the fixing of trading conditions for example. I hear you that it has to be complied with and there is an argument again based on a ruling of the Tribunal in the past which has never been thoroughly examined but might in fact be fundamentally affected by the ANSAC decision that any trading condition does not mean what it says. It means something connected with price or quality.

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MR RAYWOOD: And so we would still, we would still suggest that it is a structural test, it is not assesses to whether the Competition Commission thinks more in the level of interchange as better than another level of interchange. Interchange is too high or interchange is too low, it is simply not the role of a competition regulator under Section 4...

ADV PETERSEN: Yes.

10 MR RAYWOOD: It remains an instruction inquiry.

ADV PETERSEN: I hear you entirely Mr. Raywood but if one brings it back to..., if one brings 4(1)(b) back to what has been noted earlier in this discussion, fundamentally a test of purpose right? Then there is no price regulation involved there.

MR RAYWOOD: Absolute correct, yes.

20 ADV PETERSEN: The practice would have to be evaluated and characterised with reference to its purpose or object and all I am raising with you is whether I would be

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right or wrong in concluding that in concept if one could establish that interchange is being used as a platform or mechanism for the purpose of achieving an anticompetitive object then provided the other criteria in 4(1)(b) were satisfied, it could be fitted into 4(1)(b).

MR RAYWOOD: No I think we accept that.

(Caucus)

10 CHAIRPERSON: I just want to comment because I do not want to interfere or to it
sort of disturb the debate which is going on but transplanting foreign jurisprudence, I
think there has been a lot of warning about it brought from the Constitutional Court
and the competition of pre-card. I think if you look at Federal (indistinct)
competition of (indistinct) particular because when it comes to Competition Law, it is
influenced by amongst others the economic policies and history of the country at the
time. So unless you understand what was the political history and policies of the
20 time, they might just transplant principles which not necessarily be applicable. I
reason this because of the debate that was going on about interpreting Section 4(1)

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and Section 4(1)(b) as to whether one can deal with them in the manner in which it was been suggested. Oh in the manner which is suggested by the Supreme Court that is all, it is just a comment.

MR RAYWOOD: Mr. Chairman I think that is absolutely correct, France (indistinct) will only be of persuasive effect. It would be very adequately make precisely the point I was seeking to make when we compare South Africa and Australia. South Africa should not adopt the approach of the Reserve Bank of Australia in
10 intervening in interchange without understanding what is been going on in Australia and those figures were intended to highlight the differences.

CHAIRPERSON: We are ten years down the line. The Social Commission Provisions of our act would not make sense to anybody unless they understood where we are coming from in South African at this particular junction of our history.

ADV PETERSEN: Now I am not going to ask you anything about the proper
20 characterisation of interchange even of itself because up to now I am satisfied that it is necessary for the four party scheme although I might be persuaded otherwise in the

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course of the deliberations of the panel. But now you make the policy point that the Competition Act and the Competition Legislation is not really the appropriate place to be scrutinising and find detail, price levels and indeed other trading conditions and I agree very much with that approach but then it seems to me that you argue yourselves and you argue us into a consequence of that which we have to take seriously. Although you may not accept that setting of interchange is open to abuse, we may conclude that it is in which case we would have to seriously consider what is the appropriate way that in South Africa that possibility should be addressed and that then leads us into the sphere of regulation which you have dealt with in your presentation and you have slides warning us against advisement, unattended consequences of regulations area.

10

But that is by way of introduction what I am going to ask you now. You heard in previous sessions emphasise upon transparency and so you addressed that by saying that when MasterCard does settle to fault interchange for South Africa it would be made transparent. That is the result that would be made transparent, would you say about transparency in the process?

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MR RAYWOOD: Sir I think we have described in previous interactions exactly what MasterCard's methodology is. It starts with the cost study..., we build on that and we come up with a rate. We say that there is no more reason for that to be transparent than for any business to be transparent about how it comes up with a price.

10 ADV PETERSEN: And then there was another policy objective which has been referred to many times which is objectivity in the methodology. You did not address that earlier, would you care to address that?

MR RAYWOOD: Sorry could you just expand on what you mean?

20 ADV PETERSEN: Well that..., that..., you see you talk about a cost study. As I understand it, I know you are speaking very briefly, I understand it that the..., this..., the balancing exercise which interchange has designed to achieve involves evaluating costs on two sides of the two sided market and it involves evaluating elasticity of demand on the two sides so that the balance can be achieved. You may have a methodology which cuts down or limit or narrows the need to inquiry into certain

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aspects of cost and so but nevertheless there is a balancing exercise so that the cost incurred by acquirers and issuers are brought into reasonable balance in relation to the elasticity of demand on the part of their respective customers and that the exercise, the methodology of arriving at appropriate interchange has to address those dynamics.

10 MR RAYWOOD: Yes I think you know our point since the interchange is above balancing demand and you start with demand, not with cost and the way we balanced demand is to look up costs but demand is the overriding imperative that interchange needs to balance in order for the four party scheme to optimise its issues and acceptance of it.

20 ADV PETERSEN: But the..., where the setting of interchange and I know it is only a default in your scheme as I understand it. It can be bilateral arrangements to the contrary between participating banks. Both the methodology and ultimately the level that is set come down in the final analyses, the business judgments, in this case obviously on the part of MasterCard.

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MR RAYWOOD: That is correct in the exact same way that setting a trade condition or setting a price by any merchant who has dealt with business judgment.

ADV PETERSEN: So would you consider this misconceived to pursue the idea which is actually found support in these hearings from several South African banks that there could be a process leading up to the determination by agreement if possible otherwise by some kind of deadlock break in decision making whereby an objective methodology for inquiring into these conditions which need to be assessed could be arrived at and re-evaluated from time-to-time so that it does not become cast in stone. Then a process of independent third party gathering of the necessary information from the participants on a confidential basis, then the application of the methodology to the facts and the result which is then binding upon everybody with some regulatory oversight just to see that the exercise has been carried out with integrity. You..., it would seem from your approach that that is in fact not a road that we should be travelling on.

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MR RAYWOOD: Sir I am very conscious that interchange does not exist solely in the MasterCard scheme and part of this inquiry will properly exploring to change in other payment streams where there is no entity like MasterCard. We say that that inquiry is not necessarily..., would not be helpful in relation to the MasterCard scheme.

10 ADV PETERSEN: Now in the approach that you intent to implement and are currently implementing, you arrive at levels of interchange default interchange for South Africa. You have indicated that given the current stage of development of the market, you would limit that to three..., interchange under three heading, credit cards, debit cards and hybrid cards.

MR RAYWOOD: That is correct.

20 ADV PETERSEN: Right so to the extent that at this stage there are premium cards, somebody yesterday referred to super premium cards. In the market they would not in your present intention attract to different rate of interchange.

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MR GROBLER: The intention is that we would like to categorise the interchange rates in the three levels that you referred to. In our..., I think in the next phase it maybe possible to apply business discretion but to be limited to the cap of the cost study that we have.

ADV PETERSEN: Okay the reasons that I am raising this with you is because in the general field of interchange and the attitude of merchants towards interchange. So if one comes across a particular objection to the honour or cards rule which is in the form or an objection to something that is called the honour or products rule to subset as I understand it, the honourable cards rule where it is contended by merchants that if that is subject to they do not, these merchants that I have in mind, they do not mind an honourable cards rule if it means that they cannot reject a particular customer who is carrying a card of a scheme. That they have signed up for of a type that they signed up for but they are raising objection to having to accept all cards under that scheme or under that type of card even where the merchant service charge, the level of merchant service charge deriving presumably from the level of interchange is regarded by them as an imposing and unreasonable extra cost on them for which they

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are not getting a reasonable extra benefit. And that they have no choice in the decision to accept or to sign up for some cards and not for others at the present time that seems that problem do not arise because you have uniform interchange in these different types and no different interchange for premium cards. So I am trying to anticipate what if you move into a situation in a year or a few years where suddenly you start introducing significantly different levels of interchange and we have ignored the problem of the honourable products rule.

10

MR RAYWOOD: You are correct to identify that. That is not an issue that is come up in South Africa. We are very conscious to merchants elsewhere in the world but particularly in the United States have raised that and the distinction seems to be between credit and debit. So a merchant has not been compelled to accept certain credit cards but can accept debit cards. That of course requires a degree of market definition. It is something we have not explore in a great detail but I think you know MasterCard's position in our market is payment generally includes not only for

20 MasterCard, Visa cards and Amex cards but also other methods of payment.

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10 So we have to..., a regulator or a merchant whoever the right prosecutor was if you like, would have to define a particular market which it was been suggested that merchants should not be required to accept cards in the market. Now premium cards, I do not think there are any premium cards in South Africa, am I correct other than somebody do you are absolutely right it attracts the same interchange rate as the credit card. Premium cards are considered to be a sub sort of credit cards. So to the extent that you are looking at similar developments around the world then we would still have premium cards and standard credit cards within the same bucket if you like. They would not be splitting up premium and non-premium.

ADV PETERSEN: When it comes to interchange?

MR RAYWOOD: When it comes to merchants around the world saying “we do not want to accept this type of card,” it tends to be credit or debit not premium or non-premium within credit.

20 ADV PETERSEN: And finally...

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MR RAYWOOD: Sorry just one clarification, I think we are talking about the same thing but the difference between the honourable cards rule not with products rule, I think we have agreed that merchants do not mind the rule which prevents them from discriminating against the particular issuer of the card. I think we are talking about a normal cards rule.

10 ADV PETERSEN: Then finally on acquiring, you contrasted MasterCard with Visa and referred to a rule which I make no comment of the requirement of 15% of issuing country that the Visa imposes before allowing the customer or member bank to acquire. Is it not true that MasterCard although not having a rule like that nevertheless does restrict its acquiring licences to institutions which have a substantial issuing basis?

20 MR RAYWOOD: Sir the point we were making before is we do not have acquiring licences so we do not have that structural point that Visa may have and I am precise, I lift it up from the FNB transcript. I do not know if Visa does have that rule but perhaps I can help you in terms of you where MasterCard does differentiate between

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acquirers and actually I think FNB explains this rather well that acquiring is a business driven by scale. So where you have a..., if you like a immature market and a big acquirer from another country comes in and this is like and just to have these volumes to my existing infrastructure and it cleanup on the acquiring side of the business, I think the four party scheme have mechanisms in place to avoid that acquirer coming in and giving nothing to the issuing side of the business and I hope some of those figures I showed on South Africa and the contrast with Australia display is that on the acquiring side, is pretty competitive.

The problem with South Africa is not bringing in more acquirers. You heard Mr. Monsen say that before acquirers never have trial issuers but the issue is about right and replicated around the world. So you do not have if you like barriers to access to the acquiring market which I think some of these questions are driven at. The big problem is on the issuing side, getting more people into the banking systems, getting more cards out there and having them use those cards for the (indistinct) and to improve the social economic position for the country.

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ADV PETERSEN: Would you..., a part of your normal business practice expect a bank, which wish to become a participant in the MasterCard scheme and wish to in particular to acquire also to satisfy you that it would achieve a significant contribution to your issuing base.

MR RAYWOOD: It is a simple yes.

ADV PETERSEN: Yes and would there be any way that that aspiring entrant would
10 be..., would know objectively what kind of volumes they would have to meet in order to satisfy you?

MR GROBLER: Yes I think we are very clear in terms of our requirements on that so we will share that with a potential member yes or customer.

ADV PETERSEN: In your rules, I think you talk about financial institutions rather than banks specifically and you will know that in this inquiry we have been pursuing a difficult idea about with due caution suggesting the opening up of the acquiring
20 space to entities other than banks, having heard all of that and read whatever what

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maybe in the transcript, you have anything to tell us on your attitude to non-bank acquiring?

MR RAYWOOD: Yes I think our test is that we need to have a regulated and supervised financial institution. I think many of the banks already made the points about systemic risks and we cannot introduce new entrants when they likely to pose a systemic risk to the system. So the entities that would come in would have to be regulated and supervised by a competent regulator.

10

The only other issue in the context in which this point tends to come up is you have a large retailer which sets up a financial entity and then seeks to start acquiring and our only point we would want to make is that we..., the role of the acquirer involves monitoring the merchant and if the acquirer in this case the financial institution established by the merchants, if that acquirer is in the pocket of the merchant then we have concerns as to how that financial institute could monitor the merchant and ensure that its practices were proper. Other than that we do not have a particular issue with something that does not look like a deposit taking institution becoming a

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customer of MasterCard. If they can proof to us that they are going to grow the scheme and that has to be good for us.

ADV PETERSEN: Would they be capable of issuing because you tie acquiring to issuing and so if I wanted to be an acquirer chances are I would also have to be able to issue. Can a..., are there non-banks that issue another name, I am not just talking about a label. I am talking about the issuing relationship.

10 MR RAYWOOD: Sorry can you just repeat that?

ADV PETERSEN: Well is the issuing necessarily tied to deposit taking?

(Caucus)

MR RAYWOOD: Sir I think the criteria in its past participate in the clearing and settlement system. When I was talking about the deposit taking institution that is our typical definition of a bank, we are not restricted to deposit taking institutions as customers of MasterCard.

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ADV PETERSEN: Thank you.

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CHAIRPERSON: Well some of the questions I wanted to raise have been covered. I have got two thought once, slide 8 and 9, the last line, second bullet last line, you say MasterCard interchange setting a methodology as probably pro-competitive effects and then it says increasingly a low economic payments creating that is also economic welfare. Can you explain for what you mean by that? How does it create social economic welfare?

10 MR RAYWOOD: Sir this is part of the challenge to bring more beyond bank to population in (indistinct) stream, it sits more we call the “war on cash.” Now we got to device products, Mzansi I think is a step in the right direction to get people away from the cash based point in business into the card based system on to the banking system and that creates social economic benefits for a country that tends to be regarded by every regulator including the Reserve Bank.

20 CHAIRPERSON: I thought maybe you have your own systems you are talking about not necessarily Mzansi, you only confronting this from Mzansi here?

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MR RAYWOOD: No sir what I am..., more this point 6 to say is that interchange it is a device by which MasterCard optimises its output, you have heard that for several times. We expand our (indistinct) and we expand our acceptance. Get as many cardholders involved as we can, get as many merchants involved as we can and it is through interchange that we do that and that extents in all directions to the lowest segments to the highest segments and form part of bringing more volume into the bank system and hopefully into the MasterCard scheme.

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CHAIRPERSON: Okay, slide 9. I just want to be sure that you not slide..., you are not suggesting that we would..., cannot question the level of interchange?

MR LEON: No we are not saying that Mr. Chairman, we are saying that the level we look..., the issue of the level of interchange, you need to really conduct a Section 8 inquiry. We are not saying you cannot question it, we are saying you should not question us under Section 4.

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CHAIRPERSON: Okay.

MR LEON: That is all we are saying.

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CHAIRPERSON: Alright that is all I wanted to find out, thank you and thank you for coming again as we would not have..., we would not have them all together and we really appreciate that. Now we (indistinct) system, the inquiry have responded. Thank you I think you would to (indistinct), we will then adjourn for a 30-minute tea break. We then come back in 30 minutes.

(Tea Break)

10 On Resumption:

CHAIRPERSON: Right then ladies and gentlemen just one same old housekeeping issues, our cell phones please and welcome to the PASA team, Mr. Nthla, Mr. Coetzee, Mr. Pienaar and Mister..., it is Mr. Altin?

MR ALTINI: Altini.

CHAIRPERSON: Okay welcome and thank you for coming back again. The last time we had a discussion and we did not finish and we all did not finish and we

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decided we will finish off some other time. Thank you for arranging a suitable time and coming back. We can then proceed.

MR COETZEE: Thank you Mr. Chairman and members of the panel. We have not prepared a presentation for this hearing but we will take you through some of the issues that we dealt with since the last hearing.

CHAIRPERSON: Right and if..., oh by the way before I forget, also thank you for
10 letting us get copies with all the pages.

MR COETZEE: Thank you.

CHAIRPERSON: So at least now we could follow clearly what was..., what the documents were saying, thank you.

MR COETZEE: That was in fact one of the points that I wanted to deal with since the last hearing, we have provided you with complete copies of the documents...

20 CHAIRPERSON: Right.

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MR COETZEE: We have also provided incorporated in that document is a letter from the Reserve Bank in terms of which PASA was recognised as the payment system management body. Also incorporated is the slide presentation of the previous, of the 29th presentation.

CHAIRPERSON: Right.

MR COETZEE: We would like to request you if we could provide you with
10 additional documents. The one is a letter explaining some of the issues and the second is the table, an updated table provided by the Reserve Bank. If you recall the PASA submission makes provision for a table on page 20 in terms of which confidentiality was claimed. That table has been updated and this is attached to our letter. We will also provide you with Rules, previously provided to you but we have highlighted the sections that the PCH participant groups deemed or perceived to be confidential. Also in that batch you will find those rules that have been highlighted
20 and have been deemed as confidential.

CHAIRPERSON: Okay.

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MR COETZEE: Mr. Chair I do not know whether you would want a moment just to work your way through the letter, the PASA letter but I can take you through the salient points of that letter.

CHAIRPERSON: Of that letter, right if you could that would in the..., you mean the one addressed to Mr. Wilson, Chairman of Payment Association of South Africa?

MR COETZEE: It is the...

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CHAIRPERSON: The one dated the 9 June.....99?

MR COETZEE: It is a letter with the PASA logo and the heading "Competition Commission PASA Documentation Confidentiality." Now this letter essentially deals...

CHAIRPERSON: Oh...

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MR COETZEE: Yes, yes that is the letter. This letter deals with confidentiality. In principle PASA has agreed to waive confidentiality in all its documents. The PCH Agreements and Clearing Rules, there is however a request that the PCH agreements

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and the clearing rules not be made available on the Competition Commission's website at this point in time but that the Commission is free to ask any questions from those PCH agreements and clearing rules. We have not had sufficient time from a legal perspective and from a time perspective to deal with all the issues in the whole document.

10 As far as the clearing rules are concerned, we have identified in the paper, PCH clearing rules as well as the RTC PCH clearing rules, some of the rules that might perceived to be confidential and that is based on technical processing information. The immediate settlement PCH clearing rules, there is no claim on those rules but what we have done is, where it provides for message codes, fields, clearing codes and so on, we have replaced that with a fictitious code.

20 In the second clearing rules provided there, we have added the RTC, real-time clearing PCH clearing rules. The new pay PCH clearing rules have been removed because that PCH will terminate shortly and an updated version of the EFT PCH

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clearing rules have been incorporated. Mr. Chairman, that is the extent of my presentation and also dealing with the letter before you.

ADV PETERSEN: Mr. Coetzee could you just help us with this? The particular parts of the documentation which are still to be treated as confidential, how are they identified, how will we know?

MR COETZEE: We have provided you with a letter appended to our letter stating
10 which rules are confidential and we have also highlighted and what I have said is that only the paper PCH clearing rules and the EFT PCH clearing rules are affected by these claims that is one of the...

ADV PETERSEN: Oh sorry I have found a page where there is highlighting in blue...

MR COETZEE: Yes.

ADV PETERSEN: Is that the way you have done it...
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MR COETZEE: That is how it is indicated.

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MR NTHLA: Mr. Petersen just to add to that there is also a CC7 that has been filed together with the confidentiality claims. The CC7 sets out the specific clauses in each of the clearing rules as well as the references to the page numbers. So it is very clear which sections are confidential.

ADV PETERSEN: Thank you.

CHAIRPERSON: So that will be your presentation for today...

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MR COETZEE: That is my presentation...

CHAIRPERSON: You do not have anything else to add to your previous presentation?

MR COETZEE: Yes that is it.

CHAIRPERSON: Alright thank you, let see whether the panel members have got any questions for you.

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MS NYASULU: Should I go? Just a few questions some of which I asked you the last time but I just need clarification for. You have said in some of your presentations that PASA requires input from the PCH participants and PCH participant groups to authorise a payment system operator. Now the question I want to ask is, taking and bearing in mind the ownership of Bankserv, who by their own admission and their presentations here are very volume driven, would it be your sense that that creates a conflict of interest environment in the fact that the people who have every vested interest in ensuring that volumes go through Bankserv also have a right of veto in terms of who actually becomes a PSO.

MR COETZEE: It could be perceived as a conflict of interest, yes, but once again the PASA processes I think provide for an answer to this problem in the sense that the entrant participation criteria that the Reserve Bank has approved and the PCH participant group will consider from an operational point of view, whether the PCH system operator complies with the operational and technical aspects of the criteria. So from that perspective they will then make a recommendation to PASA council. They are not the risk..., the PCH participant groups are not the risks committees.

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They will only consider operations and technical issues. Make a recommendation to PASA council where this authorisation will be considered. Ms Nyasulu if I could just ask Johnny to add to that

MR PIENAAR: I think it is important to understand the process. Any two banks can create a PCH and any two banks can appoint a PSO PCH system operator. Again the issue for those banks will be to assess on a business basis whether it is better to join an existing PCH and use an existing payment system operator due to the volume
10 issue than to create a new one. So it is not a question of a barrier to entry or a decision to block a new PCH system operator to be appointed. I mean therefore we have got Visa/MasterCard/Strate, as well as Bankserv already in the system. I think it is more a question of the type of transaction that is involved and whether it is cost wise proper to create a new one if there are banks that wants to do that.

MS NYASULU: But supposing that I wanted to set my self up as a PSO, in other words competing with Bankserv in this particular..., in a particular payment stream.
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I still need the permission of the people who own one of the PSOs basically to allow me to operate.

MR PIENAAR: No it is not like that. What you have to do, is you have to market yourself and if you can market yourself to two banks to start using your system, you are in play. So it is not a question of you need their permission, you have got a market yourself. You got to setup your operation, you got to market yourself to the banks and if you can find at least two banks that is willing to use your services then you are in play and you are competition for Bankserv.

MS NYASULU: Okay thank you. The next question has to do with a..., and I am not sure the extent to which you are aware of LINK in the United Kingdom, which basically operates in the same way that ATM schemes here would operate and using the same principles, core principles of BIS, and in that scheme, which again you must think of that scheme in the same way that you would think of a PCH participant group, but within that scheme the person who would be able, who would take the role of actually assessing whether a participant can play, the rules, the business plan of

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that, is what is called “an executive director” which in our case is PASA. Do you see yourself in the case of South Africa that a new entrant to the ATM PCH would have to obtain permission from each existing participant as opposed to what is happening there where one individual basically the executive director would make a decision?

MR COETZEE: I can refer you to an example in the PASA environment...

MS NYASULU: Yes?

10 MR COETZEE: We have Bankserv as the PCH system operator in terms of several services. One of which is the ATM service however there are currently one other PCH system operator that has been authorised to process ATM transactions in South Africa and we are in the process of looking at another PCH system operator to perform that function. And they perform that function in competition with Bankserv and it only took two members in addition to what Mr. Pienaar stated, it only required two member banks to approach PASA with an application and that application was

20 approved.

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MS NYASULU: I have actually moved off the PSO question to an ATM PCH participant. In other words take a bank or whoever another bank, the rules say that that new participant would need to get written permission from each and everyone of the banks and I am not sure if you were here yesterday but I gave the very ridiculous analogy of a polygamous marriage where it is ridiculous to have the two wives who are already in the marriage, regulating if a third wife should come in because they have a vested interest in saying there is enough of us in this family.

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So I am asking whether you anticipate in South Africa that a system where an executive director or in this case someone within PASA is the one that makes a ruling on whether the new or would-be entrant in the ATM PCH or whatever PCH meets all the requirements so that they do not have to ask the wives who are already in the marriage basically.

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MR COETZEE: Yes there is a requirement that the new entrant must negotiate with each of the participants in a PCH and what we referred to is a letter of confirmation by the other participant to allow the new participant in the PCH. Now there was a

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specific reason for that requirement and the requirement is based on the fact that each other bank will have to make a risk assessment of the new participant and also to expose the new participant to the other banks and to enable them to commence discussion on bilateral pricing. However, do I perceive whether such a decision will vest in managing or executive director in PASA? It is it possible, it could be, but I do not believe the function performed by obtaining letters of confirmation will be achieved by one person sitting in PASA.

10

MS NYASULU: Okay I am not being too clear about what I am trying to achieve. What I am trying to achieve is taking, remember last time I said the tail is wagging the dog a little too much. What I am trying to do is to get the dog to have control of its tail and to work the tail itself.

MR COETZEE: Yes.

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MS NYASULU: So I am trying to take the power of regulating who comes into the system out of the hands of the banks into the hands of the Regulator whether it happens you know by way of an executive director or a Board within PASA is

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immaterial. It is a matter of institutional arrangement. It is who makes those decisions, should it be the banks which essentially is what is happening now if you ask a new entrant to ask the permission of each and every bank, you put the power in the hands of the banks. My question says, is it possible or should it not be the case that the Regulator makes those decisions rather than the banks? Following whatever principles, whatever the criteria are whatever the requirements but the person who actually says “yah or nay” to an entrant should be the Regulator surely and not the users of the systems.

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MR COETZEE: I think I will ask Mr. Pienaar to respond to this question.

MR PIENAAR: Yes I think again we need to understand exactly the process and why the process has been setup to err rather on the conservative side. The only reason why a bank and you may remember that we said we had 80 approaches I think or 84 approaches to join PCHs and not one was declined. The process that we follow and why we follow the process of discussion is that there is risk involved and you will remember we said that the main risk lies in settlement at the end of the day

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therefore we allow that process to run on through the banks however that particular bank that you want to wag its tail can wag its tail if he so wishes. Should there be a reason, the process is very clear. Should there be a decline by any bank on allowing a person into the particular PCH, it needs to be based on a risk reason. If that is the case that particular decision will have to be escalated to PASA council with the reasons of the banks that he is declining and make clear why it is, and at that point in time council can change the decision. If council does not do that and agree with that..., the particular bank has got a choice to go back to the Reserve Bank and ask the Reserve Bank to allow it to enter the system and the Reserve Bank can make that particular decision in terms of the process to allow the bank into the playing field already.

10

So to an extent it is to..., it is a sense that we maybe erring on the conservative side by allowing the people to discuss with that particular bank its position, to understand its position, but in the end finally the decision lies with the Reserve Bank should there be a decline on the side of one of the banks. So it is just a question of allowing the banks to go about their business as normal without interference by the Regulator

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unnecessarily and that is why the term that has been chosen to regulate the National Payment System is also oversight and not regulation. It is in other words, to my mind at least, a lighter sense of regulation than having the Regulator always take the decision from that perspective but rather have the people that is in play, in the system make the decision.

MS NYASULU: In other words self-regulation is it the term that applies in this case?

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MR PIENAAR: It can never be seen as total self regulation it is rather allowance within rules and positions set out by the Regulator, allow the players to play but if they go outside of that then obviously the Regulator will come in. So it is not totally self-regulation, no.

MS NYASULU: Can I just move you to one of the issues that have been discussed by the Panel and that is the issue of the direct charging model and I assume you would have been here yesterday when Standard Bank were presenting and said as have other banks that they would support a direct charging model for ATMs. From

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the PASA perspective, what sort of changes do you anticipate would need to be made to actually accommodate a direct charging model.

MR COETZEE: I do not perceive any changes from a PASA perspective to take place. PASA is involved in the regulation, organisation and management of its members as far as the operational participation in PCHs are concerned, however, that the pricing and how they charge clients is not in the PASA domain.

10 MS NYASULU: Thank you Mr. Chairman.

CHAIRPERSON: I just need clarification, you made reference to the regulation of the numbers with regard to participation in the PCH and you are talking about, I am not sure whether I understood you very well that the role is more of an oversight role not a regulation role.

MR PIENAAR: Yes Mr. Chair, if you look in the NPS Act also it talks about overseeing the payment system instead of regulating the payment system. I think to
20 an extent also in the NPS Act, you find that the bank..., that the Reserve Bank will

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issue directives and not *per se* regulations although the directives is also published in die Staatskoerant...

MR COETZEE: Government Gazette.

MR PIENAAR: Government Gazette, it is not..., I perceive it not to be as exact as for instance the regulations of the Bank's Act as versus the NPS Act. In other words there is less interference according to me, from the overseer in specific arrangements
10 that the banks have between themselves as long as they play within the set out Bank of International Settlements Principles of the Reserve Bank and its Vision 2010 that are set out.

CHAIRPERSON: You wanted to say something else?

MR COETZEE: Mr. Chair if I may clarify the issue, Mr. Pienaar also said that PASA will regulate each of its members within existing rules and regulations that is the self regulation part that we will perform, but outside of that domain and referring
20 to the pricing issues, PASA does not get involved and the SARB has developed rules, directives and position papers and PASA has to comply and its members have to

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comply with those position papers and directives and they regulate in that environment, they regulate self.

ADV PETERSEN: If I may just follow-up on that because we need to be sure that we are describing the situation correctly in anything that we may write. I just want you to confirm please for the record, if you go for example to the clearing, EFT Clearing Rules, a short distance into the volume. You with me? This is now then released from confidentiality, at least this page?

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MR COETZEE: Yes.

ADV PETERSEN: If I may read from Section 1 introduction, I quote:

“The NPS Act and the subsequent formulation of PASA were motivated by the concepts of self regulation, self assurance and consequently the goal of minimising inter bank clearing and settlement risk.”

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And I find the same thing, I think even in identical words in the NAEDO and AEDO rules in the Mzansi money transfer rules, in RTC Clearing Rules as well. So self-regulation even if not total is clearly seen as very substantial, would that be correct?

MR COETZEE: Yes.

ADV PETERSEN: It is substantially a system of self-regulation subject to regulatory oversight, would that be correct?

10

MR COETZEE: That is correct.

ADV PETERSEN: So if someone were to say to us “you would not find self regulation anywhere in the NPS Act” that maybe true of the words but it would not be true of the concept.

MR COETZEE: Yes, I agree.

20

MR PIENAAR: Can I just make a comment on that please? It is just also important to note that in the NPS Act there is an allowance that PASA need not be recognised,

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in other words that they need not be a payment system management body. So in that sense should the Regulator decide at any point in time to take away the...

MR COETZEE: Recognition...

MR PIENAAR: The recognition of PASA, then the only Regulator that will be there will be the Reserve Bank, nobody else.

10 ADV PETERSEN: But if I may, I do not..., and this is interrupting questions by Ms Nyasulu...

MS NYASULU: No go on.

20 ADV PETERSEN: But does it have to be presented as starkly if one is looking at future changes, so starkly in terms of either the one or the other, because as I understood Ms Nyasulu's questions to you, they were directed towards a position where some independent decision maker acting in accordance with clearly defined criteria, no doubt both for on the technical side and more generally in regard to risk management and security, would make the decision as regards the entry of a new

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participant and the existing participants would have to accept that or no doubt have some avenue of recourse through appeal or whatever if the decision was a bad or dangerous one. That could still rest..., that power could still rest at a level which is not simply the SARB. You are nodding is that something one could contemplate?

MR PIENAAR: Yes, no I agree that possible. It is however not foreseen currently in the position as I understand it from the Reserve Bank. So in that case we will..., the discussion we will have to have I think with the Reserve Bank and they will have to guide PASA into that direction if they deem it necessary from that perspective but I..., certainly it can be done.

The issue is, fall back should the decision be incorrect because it is the risk issue that is not that easy to put criteria down for. I think it is however also important to understand that initially when the PCH agreements were written, at that point in time all the risk reduction measures which the Reserve Bank and PASA has implemented was not in place yet. So at the point in time it was more important I think than it is now, with the risk..., the necessary risk reduction measures 98% of value being

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settled on an intra day basis that may have declined the need which we require. So yes it may be possible to change but I think we will have to take the note from the Reserve Bank.

ADV PETERSEN: And would you agree that the framework of oversight consisting of these directives and these position papers provide criteria only at a very general level?

10 MR PIENAAR: Yes.

MR COETZEE: Yes, it does, however, the PASA constitution as well as the PASA regulatory framework was approved by the SARB before it recognised PASA as a payment system management body in 1999. So in essence the Reserve Bank approved all these documents before it recognised PASA as the payment system management body and any changes to the constitution for instance have to be approved by the Reserve Bank as well.

20 ADV PETERSEN: But is it not also true and I hear what you say, but is it not also true that even at the level of specification that you now are talking about and an

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aspiring new entrant would not find clear objective criteria either on the technical side or on the risk management side that they would have to comply with but rather the process is that side of the process is managed through getting the agreement of all existing participants.

MR COETZEE: The agreement from the existing participants deals with the risk assessment by the individual existing banks of the new participant banks. So that..., let me put it this way. The entrant participation criteria that document was approved
10 by the Reserve Bank and accepted. One of the requirements is that each new applicant must also obtain letters of confirmation and that is the issue dealing with obtaining permission from each existing bank.

The requirement being and this has been specified is that you can only discuss risk issues and you negotiate bilateral pricing. Now if there is any risk issue, it must be disclosed to PASA and if the letter of confirmation is not provided by the existing
20 bank, that bank must provide reasons and stipulate the risks identified by itself and if there is a..., we have never had the situation where any of our existing member banks

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have rejected a new incoming bank. So how we will deal with it in terms of the escalation process has to be resolved.

MR PIENAAR: Can we just mention on the technical criteria. The technical criteria is actually the question of being able to test with the applicable payment clearing house system operator. So whatever technical criteria there is is in relation to be able to exchange its payment instructions via that particular system, from that perspective. So therefore you also cannot put down specific technical criteria because it differs

10 from each and every payment stream to the other and it is just easier to allow for the entrant to be able to test and not fail in the tests.

ADV PETERSEN: But surely those criteria could be established for each payment stream?

MR PIENAAR: Well to an extent it is established because you need to be able to connect and you need to test through the operator to the other banks.

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ADV PETERSEN: Is it true that a would-be new entrant either in coming to PASA or in going to the existing participant banks would be expected to disclose their business plans?

MR COETZEE: No I have in the previous presentation I have alluded to this fact. The only business plan that may be disclosed is that if a bank wishes to participate in the EFT environment, it must state its estimated volumes and values, state that I have clients, I have existing client base, this is my estimated values and volumes and I will participate. I will test and from that perspective there is - client names, client details and so on, are not disclosed.

10

ADV PETERSEN: And does that disclosure take place to PASA, to the participant banks or to whom?

MR COETZEE: In the PCH application form the prospective applicant is required to provide per PCH, for instance if it is a EFT PCH application, it will state on that application form that I am going to participate in this PCH. The PCH system operator is Bankserv, I will have the following estimated volumes and values in this

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PCH. It addresses issues of DRP, BCP, confirmation that it will sign the PCH agreement, the settlement agreement et cetera. So we do not request them to provide their business model, their details of their clients.

ADV PETERSEN: And then finally before relinquishing this, are you aware of any other country where access to the payment system is regulated in a manner which includes the requirement of consent from each of the existing participants?

10 MR COETZEE: I will ask Mr. Pienaar to address this question.

MR PIENAAR: I think we are not that *au fait* with all the systems in all the other countries but if you think about the Australian model where the banks has direct links with each other, it actually comes to that point because if the one does not want to trade with the other one, he would not trade with him. So it is exactly the same. The only difference is that we managed it through a central switch which is very more efficient. It has actually been confirmed to us by the Australians that they deem it to

20 be much more efficient than the direct link scenario they have got.

ADV PETERSEN: Thank you.

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MS NYASULU: You done? Okay if I could just follow-up and in fact it comes in quite naturally after the last question that Mr. Petersen asked. We hold up the BIS as the standard and I support that it because our economy is after all part of the global economy. However when it comes to certain definitions, take clearing for instance where the BIS defines clearing as the exchange of payment instructions, period, and yet the NPS Act defines it as the exchange of payment instructions between banks. Is there a reason why we have added the “between banks” when it is not necessary...

10

MR COETZEE: I do not think...

MS NYASULU: The case.

MR COETZEE: The NPS Act provides for exchange of payment instructions between banks. The clearing is defined as the exchange of payment instructions in the NPS Act.

MS NYASULU: Also in the NPS...

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MR COETZEE: Yes.

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MS NYASULU: It does not specify “between banks?”

MR COETZEE: Between banks, no.

MS NYASULU: Okay that is a very useful definition then. Now if we go to one of the things that is covered in Section 3 here of the NPS Act is PASA’s ability to facilitate limited membership, but you, yourselves express a certain frustration because you are unable to invoke that clause.

10

MR COETZEE: Yes.

MS NYASULU: Could you just explain what.... precisely what stops you from being able to invoke that clause to allow limited membership.

MR COETZEE: The problem with..., let me just get the appropriate section here..., it says...

MS NYASULU: 3(a)...

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MR COETZEE: Section 3(3)(a) of (indistinct)...

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MS NYASULU: Yes 3(3)(a)...

MR COETZEE: The institutions of bodies referred to in Subsection 3(3)(b) that “comply with the entrance criteria for limited membership as recommended by the payment system management body and approved by the Reserve Bank in terms of maybe granted limited membership.”

We have identified and we have made proposals in this regard to the Reserve Bank.

10 We have also alluded to this fact in our submission is the fact that if you look at Section 6, Section 6 does not make provision for or does not allow limited members to clear. In terms of Section 6 only banks, mutual banks and branches of foreign institutions may clear but the limited member is not necessarily a bank, mutual bank or a branch of a foreign institution. So that is the technical problem, sorry problem with the Act.

MS NYASULU: And do you as PASA see a discord in those two sections...

20 MR COETZEE: I think it was...

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MS NYASULU: Or a misalignment I should say.

MR COETZEE: It was yes, I think it was an oversight when we drafted the Act and that is why, I think it was in 2005, a letter was addressed to the SARB indicating that we are sitting with this problem and that we cannot allow limited members to be members of PASA. However we have allowed sponsored participation of Ithala, Post Bank into the payment system under sponsorship arrangements but they effectively clear, and well not settle, they clear and participate as each and every other member of PASA.

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ADV PETERSEN: May I follow that up?

MS NYASULU: Yes sure.

ADV PETERSEN: Can you..., in developing that practical arrangement which is clearly necessary...

MR COETZEE: Yes?

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ADV PETERSEN: Can you find anywhere where that is permitted under the Act?

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MR COETZEE: It does refer to in Section 3..., No, well the Act does not allow for membership but it does allow for sponsorship.

ADV PETERSEN: Well, does this kind of sponsorship feature in the existing position paper of SARB on banking models?

MR COETZEE: No.

10 ADV PETERSEN: So it is something that has been improvised to meet a practical necessity?

MR COETZEE: Yes this was...

ADV PETERSEN: Caused by an oversight during the drafting of the amendment to the NPS Act.

20 MR PIENAAR: Yes I think it is actually coming from history because the ones that we allow to operate, the entities that we allowed to operate on that basis actually was operating in the system before and in the past under the Post Office and Meeg and Ithala, that was before the creation of the NPS Act. So we actually had no choice

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where you cannot simply kick them out, based on a technical error that was made initially.

ADV PETERSEN: But that was an amendment that was enacted in 2004, that error.

MR PIENAAR: That is correct.

ADV PETERSEN: We are now in 2007. I would have thought it might have been corrected in the Act.

10

MR COETZEE: Mr. Petersen can I just add to that? I was actually aware of some provision in the Act referring to the situation and that is Section 3(3) which says besides the Reserve Bank the following may also be members of the payment system management body and in (b) it says an institution or body referred to in Section 2 of the Bank's Act and it goes on and in terms of that provision we have allowed the Post Bank and Ithala to participate under special provisions approved by the Reserve Bank as sponsored entities into the payment system.

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ADV PETERSEN: But you will accept that in terms of the Act they would be excluded from clearing, Section 6?

MR COETZEE: Yes.

ADV PETERSEN: And they cannot participate in the Reserve Bank settlement system in terms of Section 3(4).

MR PIENAAR: That is correct.

10

ADV PETERSEN: So again as I emphasise I appreciate the practical necessity of this, it would be absurd otherwise, but what I am driving at is that there appears to be something that has had to be improvised using as it were “discretionary powers” which are not actually provided for in the law of the land.

MR PIENAAR: I think to an extent it has been approved not so much as a directive but as an agreement with the SARB, from the SARB to PASA that they can operate on that basis and I would suggest that you..., one may interpret that particular arrangement as a directive which is allowed for in Section 12..., is it ..., in Section

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12 of the Act. So in that sense there is to my mind discretionary power. Also in the Reserve Bank Act, it allows the Reserve Bank to do whatever is necessary to allow the payment system to operate. So I think to that extent they also have some discretionary powers in that environment, but it is my personal view.

ADV PETERSEN: As far as a directive on paper is concerned, you would not be aware of one governing this would you?

10 MR PIENAAR: I think we have got a letter but not called specifically a directive, yes.

ADV PETERSEN: You appreciate the thrust of my question is directed towards the problem which it...

MR PIENAAR: Yes.

20 ADV PETERSEN: I think I perceive and not only myself of so much in this area resting with the discretion of officials without clearly transparent delineated boundaries to that decision making and the fact that the omission in the Amendment

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Act, anybody drafting an Act can make a mistake, has not been corrected since 2004, signals to me that there is an attitude here, that it is enough to have discretionary powers, rather than powers which are subject to the rule of law in the sense that we have come to understand that since the change in this country.

MR COETZEE: Mr. Petersen if I may once again back to Section 3(3), I would just like to repeat that as I said. It says besides the Reserve Bank the following may participate and then it says that those entities that or entity that complies with
10 entrance and other applicable requirements laid down in the rules of the payment system management body. Now as far as the Post Bank and Ithala are concerned, we obtained approval. The Reserve Bank provided entry criteria for those two institutions for participation and also payment system management body has the authority to determine rules in terms of which such entities might participate, however this clause does not say they will be allowed to clear, but the entry and participation criteria alluded to here provides that they will participate, provide a
20 payment service under a sponsored type of arrangement with an existing PASA

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member bank. So that is the current position, it is a historic position and we had to provide for it in terms of this clause.

ADV PETERSEN: Thank you.

MS NYASULU: Just final question if I may Chairman and please excuse me, I just find that simple analogies make me..., help me understand things a little better.

10 I find it a bit strange in many respects that a body that has been setup as a result of an Act of Parliament actually looks after the very narrow interest of a group of institutions and individuals rather than a general interest and to me it is just so similar to the Government or an Act setting up a police force whose members then becomes security companies and the rest of us have no say because we are not members of a body that has been setup by an Act of Parliament.

20 And if you look particularly at some of the objects of PASA, I think that is what starts to concern me even more. In your document under Section 4..., 4.1 and I am not quite sure how to..., that is under the Constitution “to provide a forum for the

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consideration of matters and policy of policy and mutual interest concerning members,” right and your members are banks in this case.

And then if you go to 5.1, “the powers in pursuance of the objectives set out in paragraph 4, the association” and that is PASA, “will have the following powers to sponsor, oppose, support procure amendment,” and I would not read anything, but “deemed capable of affecting members directly or indirectly” which in essence co-opts you into looking after the interest of banks because anything and read into that a potential competitor, could be deemed not to be or could be deemed to be capable of affecting your members directly or indirectly in the form of competition. And so you understand where my discomfort comes from with a body that has been setup by an Act of Parliament and acting for a small group of members and having such powers.

MR BODIBE: Sorry before you respond can I add a concern to that as well? Thank you. It seems to me the way your objects and powers are defined, you have a dual role, an advocacy lobby on the one hand, and an institution or organisation that has been delegated power of regulation and in a way, what makes you different then from

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the Banking Association and how do you mediate these roles. Specifically with these areas that Ms Nyasulu has pointed out because by your constitution you are obliged to advocate and put forward the interests of your members and at the same time you have a duty to look at the interests of the system and that seems to me to be a conflation of roles.

MR COETZEE: I think ultimately that the objective of PASA is to ensure that there is an efficient National Payment System but the Act specifically provides for the regulation, organisation and management of its members, being banks. Now the Act restricted the members of the payment system, membership of the payment system management body, and PASA has to regulate and manage within that domain. I do not understand clearly what is meant with the conflict with the interests of the members, the interests of the NPS, because the two according to me go hand in hand. And also if you refer to the admission of a new participant, the rules are clear. This is in terms of this process the criteria is fair and objective and as we have stated in our submission, we have not had one rejection of any application in the past.

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MS NYASULU: The problem Mr. Coetzee arrives and all of these things are setup so that not for when things are going smoothly but when things become a problem. So in pursuance of that little article that I read, if there was ever an occasion where the banks felt threatened, in other words the entry of a particular participant was deemed capable of threatening the banks you would have a serious problem on your hands because your role is to then protect the interest of that to the point where you have to oppose as specified in your constitution. That is the conflict, it has not arisen and I am really happy for you but it may just arise and the question is how then do you extricate yourself from a position where it does not threaten the NPS in whatever manner, but it threatens the members of PASA.

MR COETZEE: It might perceive to be a conflict of interest if I, may put it that way, but that is why PASA and the Reserve Bank have introduced these clear processes, these objective criteria to ensure that there is no stumbling block and that if a competitor for instance comes in that that competitor is assessed objectively and that it has the mechanisms if any such assessment is subjective and unfair to escalate to the Reserve Bank.

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MR BODIBE: Sorry Chair..., 5.1 actually creates that scenario much more clearly, if you really say your role is to sponsor, oppose, support, procure amendment of or make representations in regard to any legislation, official regulations, directives or circulars proposed or issues by the Reserve Bank, Registrar of Banks or the Department of Finance or any other department of the Central or Provincial Government deemed capable of affecting members directly or indirectly.

10 I read that to mean, if national policy was to suggest whatever, that is deemed to be against the interest of your members, in that specific situation you would be called upon to act as an advocacy group and you are no longer acting as a body mandated with a role to manage and regulate their payment system. You are now acting more like the banking council and I think that specifically for me conflates the role of an advocacy group with the role of a body that has to advocate the interest of its members.

20 Of course, this is as it stands now and I do not think going forward the role of PASA should combine these two functions because otherwise it creates a conflict of interest

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because at..., your constitution gives you obligation to represent the interest of your members at all times and you are answerable subsequently to your members and what happens in situations where you now have to oppose a position that may not necessarily be in the interest of your members but is maybe in the public interest.

MR PIENAAR: Yes to be quite honest, I do not perceive that to be a problem because at the end of the day should PASA oppose a specific proposal that comes to Parliament or that comes from Parliament, certainly PASA cannot decide for
10 parliament so if parliament would like to override PASA, they will. They will create an Act and we will have to play and our members will have to play in that particular Act from that perspective.

I think it is also just important to understand that what we are talking about here is always payment, nothing but payments because our main perspective is to handle the National Payment System from that perspective. So we will never move outside of
20 payments. So if something crops up that may interfere with our members or a

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position with our members which is outside of payments, it is not for us to follow that up.

MR BODIBE: Thank you Chairperson, I have got the following, other questions and are based on your constitution...., I now understand is available for discussion. Can you solve for me one puzzle that suggests, I am looking at the membership of the association and 6.2(1) also mentions the Reserve Bank specifically as a member, what are the consequences of recognising the SARB as a member and what are its obligations as a member?

MR COETZEE: The Reserve Bank is also participating in a number of the PCHs on the same level as any of the other participating banks. So they are also required to comply with the technical and other requirements as far as participation in the PCH is concerned. That on the one hand, the SARB is defined as overseer, the SARB is also involved as a participant. In this instance the SARB is defined as a non-voting member of the association in the PASA constitution.

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MR BODIBE: I only found one place where the SARB is explicitly excluded from the provisions of your constitution. Does it mean it has to comply with the rest of the other provisions of the constitution. The only place where...

MR COETZEE: Yes...

MR BODIBE: In your constitution that they are excluded explicitly is in relation to membership of the banking council. So does the SARB have to pay fees, have to do
10 everything else that you..., all the members have to do?

MR COETZEE: The SARB as a member of a PCH participant, has to comply with all the other requirements of those PCH's and incidentally if I may, the requirement to be a member of the Banking Association was removed by PASA council on 30 May. So our constitution does not reflect that at this point in time but we will have to amend all our documentation afterwards.

ADV PETERSEN: Just in relation to that Mr. Coetsee, what do you then do about
20 enforcing the kind of conduct because as you have explained before, the purpose

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behind that requirement of membership of the Banking Association was to subject the members to the Code of Conduct.

MR COETZEE: Mr. Petersen it was agreed that a work group will be appointed to look at the code of...the Banking Association's Code of Conduct and adopt the appropriate parts as far as a sound code of conduct is concerned and incorporate those parts in the PASA regulatory framework or the PASA constitution for that matter, so all PASA members will be subject to the same requirements.

10

CHAIRPERSON: What happens in the interim whilst you are waiting for the committee to sit which could be next year.

MR COETZEE: Mr. Chair we received an application from a bank and the application was at the same time when this requirement had to be removed, so that bank was not subject to the requirement of being a member of the Banking Association. In the meantime we will as a matter of urgency look into the Code of Conduct and draw up the appropriate rules, adopt the appropriate rules.

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MR BODIBE: Can I refer you to Section 4 dealing membership? It is specifically 4.2.3 where the Constitution states that the desired time to conclude an admission process will be six months.

MR COETZEE: Mr. Bodibe is that of the PASA constitution or the PASA regulatory framework?

MR BODIBE: I am not sure what...

10

MR COETZEE: Oh point 4.2.3 of the PASA regulatory framework.

MR BODIBE: Let see...

MR COETZEE: I think I have got the document.

MR BODIBE: You do?

MR COETZEE: Yes.

20

MR BODIBE: So it is not the constitution.

MR COETZEE: No it is the PASA regulatory framework.

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MR BODIBE: The PASA regulatory framework, okay, be that as it may, my question still stands. Where do you deal or give anybody comfort that this will be complied with and how do you deal with deliberate foot dragging?

MR COETZEE: Excuse me, could you just repeat the question and refer me to the appropriate clause?

MR BODIBE: Okay the Clause 4.2.3 which deals with “admission.”

10

MR COETZEE: Okay and the question? How does one give an applicant...

MR BODIBE: Comfort...

MR COETZEE: Comfort...

MR BODIBE: That this will be complied with, that the process will be completed in six months and wherein any of your rules or practices do you avoid deliberate foot dragging.

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MR COETZEE: I have stated before that when we receive an application, I am personally involved in dealing with that application and if you go through the process, we discuss the process, we provide the applicant bank with all the documentation and we inform the applicant bank that it might take six months. However, it depends on the applicant bank whether the bank is in a position to test whether it has systems, when will it test. So the period is not up to PASA to determine, it is up to the applicant bank because testing can take place tomorrow but
10 it depends on whether the bank has systems and I think the main requirement here is the testing of systems and after that when you have assured interoperability, you refer the application to the PCH participant group and you get approval. So it depends mainly on the applicant bank whether that six months is adhered to or not.

MR BODIBE: And what happens if your member banks drags its feet?

MR COETZEE: Well as I said I am responsible for driving the process. We have constitutional processes and we have our PASA, EXCO internal processes. When we
20 get confirmation of compliance, we immediately refer to the PCH participant group

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in terms of the notice period of 14 days where a decision must be taken. If the decision has not been taken on the basis of objective reasons and referred back to the banks, then that will take another month for the bank to ensure compliance with the requirement and then it is referred back.

We have actually never had an instance where the six months was exceeded by PASA or by its banks. We have had an instance of a bank not being able to test or not to confirm compliance and at the end of the day we also state that in our submission, at the end of the day the bank decided to withdraw all its applications.

MR BODIBE: My final question is on 4.2.4 where it states that an application..., where an application has been rejected you will inform the applicant stating the reasons for rejection. Is there a criteria..., okay first are..., on what grounds can a bank that has already acquired a certificate from the Reserve Bank be rejected by PASA?

MR COETZEE: It could be for technical reasons. It could be for risk reasons.

MR BODIBE: Where are they stated?

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MR COETZEE: What you do not see is that each of the PCH participant groups has adopted entry and participation criteria for a bank coming into the NPS. Those criteria are also provided to any new applicant bank so the bank will know exactly what to comply with.

MR BODIBE: And are they stated in a separate document?

MR COETZEE: Yes.

10

MR BODIBE: Which document will that be?

MR COETZEE: You will see also under Section 5 and that deals with these criteria on a high level. We go to Section 5(1)...

MR BODIBE: Yes...

20

MR COETZEE: It says "PCH Entry Criteria," must be a member of PASA, must have a signed clearing agreement which is signed at the end of compliance, must provide undertaking for compliant application form, must obtain letters of confirmation which I have referred to, must test successfully. Letters of confirmation

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is the risk issue that we dealt with and the systems are the technical or operational requirement.

MR BODIBE: So we can read that those will be the grounds upon which...

MR COETZEE: Yes.

MR BODIBE: The potential member will be rejected.

10 MR COETZEE: Yes.

MR BODIBE: And it escalates to the SARB?

MR COETZEE: If there is a rejection or not approval of that member, yes.

MR BODIBE: And on what grounds can the SARB override PASA?

MR PIENAAR: Because they are the Regulator sir.

MS NYASULU: Because they can.

20 MR PIENAAR: Because they can, it is as simple as that.

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MR BODIBE: You see that does not give me comfort.

MR COETZEE: Mr. Bodibe if I may, if the bank has not tested and the PCH system operator and the banks, existing member banks do not confirm testing then there is no way that we can allow that bank into the system. So if that bank objects to the decision not to allow it, then surely the Reserve Bank will have objective and fair reasons for not allowing the bank into the system.

10 MR BODIBE: So in this case the Reserve Bank will defer to PASA?

MR COETZEE: Well they will rely on the recommendation or the input from PASA, yes.

MR PIENAAR: They may...

MR BODIBE: Sorry did this mean...

MR PIENAAR: They may argue...

20 MR BODIBE: Yes...

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MR PIENAAR: They may..., they may not all, they may. It is very important to understand.....

MR BODIBE: When you practice..., considering that they are not involved in the mandane process of managing the system they are more likely to defer to your judgment.

MR PIENAAR: Yes I think what is also important, the Reserve Bank will know
10 whether the bank has complied, because remember the Reserve Bank is the provider of the settlement system and one of the compliance issues is for that bank to also be able to comply testing with SAMOS. So logically if it cannot test with SAMOS the bank need not refer back to us. They can simply go through to their own decisions done on whether the bank has complied with regards to testing with SAMOS or not.

MR BODIBE: What comes first between application for a banking licence and application for PASA membership?

20 MR COETZEE: You must be a member first, a bank first.

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MR PIENAAR: A bank first.

MR BODIBE: So you must be a bank first.

MR COETZEE: Yes.

MR PIENAAR: Yes.

MR BODIBE: And thereafter you apply for membership.

10 MR COETZEE: Yes.

MR BODIBE: And then PASA can then reject you and then the Reserve Bank, I am trying to understand the process by which and on what ground will the Reserve Bank now hear the appeal and on what can it waive that appeal when first and foremost it decided to give the bank the licence and now it is subjected to all these other processes that include member banks and who then decide to reject that bank and then it comes back to the SARB. Can or I..., is there somewhere where...

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MR PIENAAR: Again I, Mr. Bodibe, I think it is important to understand there is 22 PASA member banks and I think there is about 53 banks. So logically in most instances a bank will first be a bank before it applies to become a clearing bank or before it decides to become a clearing bank because by allowing payment instruments into the hands of its clients or wanting to do that, the PASA position paper then depicts that it must become a clearing bank from that onwards and from that onwards it will follow the process and that was the same question I think which

10 Mr. Jali asked last time “where is the training ground” and my perception is still that whilst that bank is operating before the time, he will have a relationship with another bank, he will discuss it with banks, he is free to come and discuss it with PASA before he decides to issue payment mechanisms to his clients.

And that will tell the bank logically to think about it, it is a highly regulated environment, it will tell the bank *per se* that I need to have systems, I have to create systems before I can even apply to become a clearing bank from that perspective.

20 And I think in that sense the situation that you are trying to find out will happen, will

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probably never happen because the knowledge will be there on what he needs to do before he can apply for the particular position that he wants to follow.

MR BODIBE: So there has never been precedence where PASA rejected an applicant and the Reserve Bank waived?

MR PIENAAR: No, no and I think the only thing that may ever happen if it does ever happen, maybe based on the risk grounds and not so much on the technical
10 criteria grounds, rather on the risk grounds if ever something like that should happen, it maybe on that basis.

MR BODIBE: Thank you.

MR COETZEE: I may just add and it is not specifically to this subject but your question, when will the SARB intervene or when will it overturn a decision of PASA, we have alluded to that specific aspect in our previous presentation when we said two
20 banks applied for a certain level of access to the payment system and it was not approved by PASA, however the Reserve Bank decided that their participation must

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proceed and PASA must allow them in the system under an objective criteria and so on and we mentioned the banks, Capitec and African Bank.

CHAIRPERSON: I see the time is 13:00, I do not know how you are placed for...

MR PIENAAR: We can carry on until tomorrow.

CHAIRPERSON: After lunch, I am talking about after lunch.

10 MR PIENAAR: No we are fine.

CHAIRPERSON: Alright can we break then for lunch, we will reconvene at 14:00.

I promise you we finish by 15:00.

MS NYASULU: Latest...

(Lunch Break)

20 CHAIRPERSON: Right just a reminder about cell phones. Welcome again Mr. Coetzee and the team. Just got a couple of questions, I have got a couple of questions then we will take it forward from there.

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10 You..., I am not sure whether you have been following the proceedings, you know there was an issue about the signing..., the negotiation of..., be the negotiating of the various agreements on a bilateral basis or multilateral basis, that is the PCH agreements. I think yesterday Standard Bank put up a slide in which they indicated that it has not been..., it was not possible for them to sign the PCH agreement regarding carriage fees and then also they went on to say they could not conclude a bilateral agreement with ABSA or FNB and then I had raised the question about whether they did consider the issue of arbitration, they said they thought it was not desirable. Are you familiar with the issue?

MR COETZEE: I am not familiar with the issue.

CHAIRPERSON: You are not familiar with the issue?

MR COETZEE: Well what..., specifically with what was raised yesterday, yes.

20 CHAIRPERSON: Well it relates to the signing of the PCH agreements bilaterally because previously they had been negotiated multilateral, you aware of that?

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MR COETZEE: Mr. Chair if I can just combine my view as far as the signing of the PCH agreement is concerned, when the PCH agreement is...

CHAIRPERSON: Sorry, sorry it is not actually the signing of the PCH, it is the issue of the carriage fees, negotiating the carriage fees.

MR COETZEE: That is..., and that is outside of the PASA domain.

CHAIRPERSON: That is outside of the PASA...

10

MR COETZEE: Domain, carriage fee any fee bilaterally and negotiated between two banks...

CHAIRPERSON: It is outside of your...

MR COETZEE: You see that is not in the PASA domain. We do not get involved. There is a requirement in the PCH agreement that they must negotiate their bilateral fees but we do not tell them when, where and how.

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CHAIRPERSON: Right, so the..., all the PCH agreements say they must negotiate them bilateral?

MR COETZEE: Yes.

CHAIRPERSON: Is that always been the position or it...

MR COETZEE: That is always been the position, yes.

10 CHAIRPERSON: That they must negotiate them bilaterally.

MR COETZEE: Yes.

CHAIRPERSON: Now how do you end up with fees which were negotiated multilaterally if that has always been the requirement that it must be done bilaterally, because some of them had negotiated fees multilaterally and it was only after they received some opinion about the anticompetitive nature of that particular agreement that they changed to bilaterally. How did they end up with that situation?

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MR COETZEE: I will ask Mr. Pienaar to respond to this but PASA was not involved and I think you are referring to the ATM PCH agreement. I am aware of developments as far as that is concerned but PASA was not involved in any discussions or negotiations in any of our PCH agreements since the signing of it in 2000.

10 MR PIENAAR: Yes, Mr. Jali all that I can think is they were talking about the card fees, the card interchange fees. I think at some point in time a few years ago when the debit cards came into play, the banks then arranged for a multilateral negotiation to get to a singular type of fee which they had to agree between themselves on the bilateral basis whether they do agree to that particular fee or whether they want to change it. So that is the only thing that I can think of which they may have had somebody involved from outside. It was actually from overseas, the gentleman that came to assist them because it was a total new concept in South Africa and a total new business in South Africa from that perspective, but it is really outside of our

20 domain so we were not involved at all.

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CHAIRPERSON: You were not involved?

MR PIENAAR: No.

CHAIRPERSON: Okay, I have got a second question in a number of the previous presentations before us there was a reference to the fact that your rules, do not allow the slowest mover to start the innovation. There was that submission...

MR PIENAAR: Yes...

10

CHAIRPERSON: You aware of that?

MR PIENAAR: I think what was intended to be said was that you do not need to wait for the slowest player to start innovation. The first two players can run with any innovation that they so wish. It is just difficult for one person to start an innovation if he wants to make a particular product available in a market place to other bank's customers also and if it is only for his own customers, it is not a problem.

20 CHAIRPERSON: And then what..., do you have mechanisms in place to deal with any player who might be stifling innovation in your view?

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MR COETZEE: Mr. Chair as far as that is concerned, Johnny or Mr. Pienaar just indicated that any two banks wishing to establish a new payment service may do so and they may then go live as far as that service is concerned. Any other bank wishing to join thereafter may then join when they are ready and that is in the PASA environment. The slowest mover will just wait until it is ready to join the payment PCH...

10 MR PIENAAR: Or may never join...

MR COETZEE: Or may never join.

CHAIRPERSON: Or may never join, okay.

ADV PETERSEN: Just following that, where one or more players identify a useful innovation within an existing payment stream, presumably there the slowest mover could determine the outcome, would that be right?

20 MR PIENAAR: I do not think so Mr. Petersen because and that is the beauty of having this central system because normally what we then do is we allow the central

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system to change and assist the two fastest players to carry on with their business and bring in the others as is necessary.

ADV PETERSEN: Is that a power that rests with PASA itself?

MR PIENAAR: Well it is really not written anywhere or a power anywhere, it is just a logical way of doing business where the banks agree that with the PCH system operator and carry on, on that basis. We have got examples of that in the latest two
10 new PCH's, the AEDO PCH and the NAEDO PCH.

ADV PETERSEN: Thank you. Now this morning you were asked about changes that might be needed to allow for direct charging in the ATM payment stream and you dealt with that. I would just like to take that issue one step further. You would be aware that in the course of this Enquiry there has also been raised the issue of the possibility of direct access to the switch by non-bank ATM service providers. Now accommodating that kind of change would seem to involve quite a lot more. Are you
20 in a position to tell us what might be involved in making that possible?

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You appreciate that I am wanting you to assume here that there would have to be compliance with not only technical standards but whatever other risk management criteria might be appropriate for such enlarged access, but we are talking about a non-bank being able to introduce transactions in the ATM stream directly into the switch.

MR COETZEE: May I just clarify the question that non-bank, will it perform the functions of a bank?

10 ADV PETERSEN: Well it seems to me that, and please correct me if I am not understanding it properly, that there are two conceivable scenarios. The one is that that bank would have an arrangement with an acquiring bank to do the collecting on the payment instruction that is generated from the ATM but not have to proceed through that bank's technical infrastructure to introduce the payment instruction. The other possibility would be to be able to participate in its own right in clearing but that obviously has all kinds of implications. So I am really putting the question to you in an open-ended way just to get an...,that we can get some feedback from you on what
20 might be involved in making a change of that nature.

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MR COETZEE: May I just for a moment confer with Mr. Pienaar?

(Caucus)

MR COETZEE: Thank you Mr. Chair, Mr. Petersen. The first scenario we see as the acquiring scenario, where a bank will acquire such non-bank and we have examples of that in the system where the non-bank already has the technical systems to link directly with the switch, but is not performing a bank function. It has access
10 to..., it has been introduced by an existing PASA member bank. The PASA member bank has the responsibility in respect of risk and any other risk issues. So from that perspective I cannot see that it would be necessary for any changes.

ADV PETERSEN: May I..., before you go on to another scenario, may I just take this one further with you? In an earlier hearing, I think it was when ABSA was sitting where you are sitting, the clearing rules relating to ATM transactions were raised and were brought up on the screen by ABSA, which indicated, it seemed to be
20 agreed, that there were specific restrictions and we can find those now and show them to you, specific restrictions to the effect that no ATM transactions were to be

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introduced into Bankserv into Saswitch other than through the infrastructure of the participating bank.

MR PIENAAR: Yes, Mr. Petersen I think what is important and I think I need to take a step back and just say that with regards to the..., before we went on lunch, the idea that we act for our members to support them always but the real point is that we do not decide who our members must be. It is a given for us in terms of the Act so if the Act changes then we can always also play for other players which can come in so I think that is important.

Based on what the existing scenario is, it is true and again I say we probably erred on the conservative side at that point in time before the necessary risk reduction measures et cetera were put into place and we were also learning to an extent how to manage this thing that we have created. So therefore you will find that in most PCH's the current scenario as it was just formalised to an extent and we did not perceive at that point in time that we may be asked this particular question.

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However should there be guidance from the Regulator or from banks, decisions from banks that they would like this to happen, it is electronically or technically quite feasible that it can happen and it happens *per se* currently in the EFT PCH.

10 The one issue that PASA raised to an extent, which we will have to investigate and agree upon if necessary, is that if you look at the BIS definition of clearing, then you may see the delivering of that particular payment instruction to that operator directly to the bank that is paying it directly, as clearing, and therefore you will then be outside of the letter of that Act as it stands at that point in time. But once again if there is a general discussion or there is guidance that needs to be discussed and decided upon, I think it can be discussed, decided upon and the necessary changes can be made if necessary.

20 So yes, it is technically quite possible yes, currently it is not allowed in the agreements probably simply because it was not like that at that point in time. As to bringing in the person under the name of the bank, that is important because that is the only mechanism that we currently have to manage a non-bank. So the question of

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the infrastructure being contracted to the bank that means the bank is responsible to ensure that it is a proper ATM. It is correctly aligned. It gets the correct information from a customer. The PIN of the customer is not compromised et cetera, et cetera and that is why those things were put into the PCH at that point in time.

10 It probably can be changed but I do not think it is for PASA to change it, I think it either needs to come from the banks themselves or from guidance from the Reserve Bank maybe or after discussion with you from the Reserve Bank from that perspective.

ADV PETERSEN: Thank you, I am going to leave it there except perhaps just for the purposes of the record and so that you can focus on it. The provisions that I was referring to specifically appear in the PCH agreement for ATMs, Clause 6.1 read with Schedule 2 and in the clearing rules for ATM transactions, the footnote on... footnote 1 on the first page of that..., I am trying to find, which arises..., the footnote arises in Clause 1.3, but I thank you for your answer. I will leave that question there.

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Now it is close to the last question but different, it is a point of detail. In relation to Track 2 data storage, for example PIN numbers, you deal with this in paragraph 7.8 of your submission and you explain the problem and how it is tackled. Could this problem be addressed by regulatory standards and inspection which would serve to exclude devices that have the ability to store such data or else to ensure that such capacity is disabled?

10 MR PIENAAR: Now personally with my payment's hat on, it is quite possible probably, the question is how do you police it? I think that is the first question. It is very difficult to police and yes it is the same difficulty that we currently have in the current environment where the banks looks after that and say it is correct and it will be correct. I think the only difference is that if it now comes out or it happens that something goes wrong, we have at least got a bank standing behind the particular risk that has come into the system which if you purely relate to regulatory environment, I am not certain that you do have that backing, financial backing or financial backing

20 for that particular thing unless you provide in the regulation that you have somebody

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that you can fall back on which I am not certain that you do have in other regulatory environments *per se* but I..., that is my personal view.

ADV PETERSEN: Thank you. If you have a look at your paragraph 7.2.1, this is under the heading of “Sort at Source” and you are dealing with that subject and you say in 7.2.1 that, and here I am reading it together with its context, that where the merchant has a direct relationship with each of several issuing banks I quote “there is no acquiring bank.” Now as I under..., I have difficulty with that for the following reason which I would like you to address please. As I understand it ordinarily in an on-us transaction there is an acquiring bank. It is just the same as the issuing bank, am I right so far?

MR PIENAAR: 50/50, can I please elaborate?

ADV PETERSEN: Well yes please.

MR PIENAAR: The difficulty with on-us transactions and everything may become on-us transactions to an extent. The difficulty with that is that you will tend to have the arrangements, and you are right to an extent that the issuing bank also becomes

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the acquiring bank. Unfortunately the issuing bank's customer who will deliver the transactions to it will be a large entity like a big retailer or something like that. The consumer on the other hand is just a little man there on the outside. If you do remove the issue of acquiring and the balancing effect that you have currently between banks, then you may find that the consumer to an extent will be out..., left out in the cold because the large player, the large client of the bank will have more say, he is bringing in more income.

10

Now currently what we have with the clearing, acquiring and issuing relationship, the arrangements that you have is that, should there ever be a dispute and it is always difficult to say what the dispute will be, but let us just for the moment assume there is a dispute where the consumer for instance says "but I did not draw the money" or "I did not pay this particular transaction" or whatever the scenario is, then at least he has got the backing of his bank versus the other bank with the particular retailer, let say for instance it is a retailer, and then we also have in that dispute where PASA has got a dispute process where it gets escalated to a legal team and they make the decision.

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Now when that is removed, you do not necessarily have it within on-us transactions and you may find that that the pendulum may sway more to the larger players than to the smaller players and your consumers maybe left out in the cold. Currently the arrangement between the banks is that any on-us transactions is handled based on the arrangements of the clearing and the clearing rules from that perspective. So at least you have got that balancing effect available. With Sort at Source if it is taken to its full extent, you will not have that unfortunately.

10

ADV PETERSEN: Well that is very important observation if I may say so. So now I just want to make sure I am understanding...

MR PIENAAR: Yes...

ADV PETERSEN: The thing technically. There would never, with Sort at Source there would nevertheless be acquiring relationships, would there not?

20

MR PIENAAR: Yes to an extent they would be..., I am not certain that the banks, you see the banks may also feel there is no and sorry for elaborating again, if you look at the large bank, he has got silos in him. He has got the acquiring side and he

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has got the issuing side. Now it maybe that the issuing guys is saying to the large corporate “but bring transactions to me and I will handle it” and they start handling it. Acquiring side may not be aware of that, so therefore the necessary acquiring arrangements may fall by the wayside because the issuing side does not know and understand what the relationship is required to be from that perspective. So that is why I say in some instances you may find a prudent bank that says “no, no fine you may say that to the customer if it is allowed, but it must still come through the

10 arrangements with the acquiring leg that we have got so that we can put all the necessary stuff in place.” In other cases it would not, it may not happen.

ADV PETERSEN: I hear you, but I just want to be sure that it seems to me that the relationship between that bank and the merchant is still the relationship of an acquirer.

MR PIENAAR: As I say to the letter of the law, yes, but it may be handled

20 differently in practice that is my concern.

ADV PETERSEN: So in practice that may breakdown...

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MR PIENAAR: That is...

ADV PETERSEN: And be a shortcut.

MR PIENAAR: That is correct.

ADV PETERSEN: Now in the range of reasons that have been advanced, including yourselves, as a policy matter against sorting-at-source. One of them is that the SARB would not have the information which it currently gets from the reporting of off-us transactions.

10

MR PIENAAR: Yes.

ADV PETERSEN: Would it not be quite possible for the SARB to be kept informed of on-us transactions as well as off-us transactions.

MR PIENAAR: Technically it is possible, it may not be done on the real-time basis or the quick time basis, let me call it that, that the SARB currently has the view of, because obviously the moment when you move it outside of the real payment and settlement environment, banks may feel that this now is an administrative

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arrangement, I can do it tomorrow, the day after tomorrow. It is costing me a lot of money so I will do it on at least most efficient but latest as possible way for instance. So from that perspective the SARB will not have that information as timeously as possible and also the effect of what settlement does I think is to look at the liquidity of the particular bank whether he can settle during the day, if there is a problem, what is the problem, what creates the problem.

10 So the red flag comes immediately with the 98% transactions that has been settled during the day through the system and then later at night with the other 8%. And I think that is a very good mechanism that one preferably from my perspective, should not take away from the Reserve Bank or try and provide it at a later stage to them. I do not think it can be as efficient as it is now.

MS NYASULU: Can I just follow-up on that one because I am trying to understand. Are we saying that the Reserve Bank does not see on-us transactions in real-time?

20 MR PIENAAR: No, the Reserve Bank actually does not see on-us transactions at all.

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MS NYASULU: And so in the case of a..., and I am trying to explore the risk side of things, in a case of a bank that has a large ATM network of its own, one can assume and I know it is not necessarily the case, but one can assume and we do have the figures for some and can check them, that most of their transactions then could be on-us transactions and so there is a large chunk of daily transactions which the Reserve Bank has no sight of until much later.

10 MR PIENAAR: Yes.

MS NYASULU: Does that not in itself introduce a huge amount of risk and so why does it become such a major risk when it is introduced by way of sorting-at-source?

20 MR PIENAAR: No, if you look at it from the big picture again, that particular environment is part of the 8% or rather not, it is part of the hidden amount that we do not see in the 100%. It has always been there. The risk reduction measures of the Reserve Bank which the Reserve Bank has put into place for instance on other environments has brought down the risk to a large extent. Also that banks as they are normally run, let say 25, 30% of the volumes and the values. So if you take the low

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end of the market and you say that particular piece of that is another 8% because currently which is cleared is 8%, so let us say it is 8%, a quarter of 8% is 2% if I figured it out correctly. So to that extent for that particular bank it is not a problem, for the total on lump of the banks is probably 8%.

10 But then it is only one bank that may go into problems but also if you relate that 8% in relation to the real-time transactions which flow currently which is 92% of value, then you know then really that is an issue because sort-at-source does not look at which transaction to sort-at-source. It just says “sort-at-source.”

So it starts doing it maybe in the small amounts, maybe in the large amounts from that perspective, and that is where your difficulty lies from my perspective, where the risk will come in.

MS NYASULU: Sir just to finish up, Rob with your permission, it really is a matter of magnitude...

20 MR PIENAAR: Yes...

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MS NYASULU: And quantum then.

MR PIENAAR: Yes...

MS NYASULU: So it is not sorting-at-source *per se*?

MR PIENAAR: No...

MS NYASULU: It is the amount...

10 MR PIENAAR: Yes...

MS NYASULU: That would be done which would not be visible so one could put in mechanisms to control the quantum and the level.

MR PIENAAR: I would say it is consequential, unsequential effects, is that the word?

ADV PETERSEN: Unintended.

20 MR PIENAAR: Unintended consequences, sorry.

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MR BODIBE: Excuse me...

MR PIENAAR: Thank you for that.

MR BODIBE: Can I make a follow-up on this? Is it not on-us transactions..., okay to rephrase the question, in on-us transactions, is the bank not really looking at the liability between its customers rather than the customers of other banks, is that a proper characterisation of on-us transactions?

10 MR PIENAAR: Yes it is. At the moment when you talk about on-us transactions, you talk about that the beneficiary and the payers sit in the same bank. Now...

MR BODIBE: So it...

MR PIENAAR: Sorry can I just elaborate further?

MR BODIBE: Yes.

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MR PIENAAR: The problem with sort-at-source is if it is taken to its logical conclusion, that you do not have any clearing in between anymore. That means everybody will have to have a bank account with each and every bank.

Now if you think about it, that will not happen because what they will do is, they will say “but you know if I bank with four banks then I will probably get roundabout 80 to 90% of transactions so that means these other guys, you know, I do not really need to have an account with them. So if their customers walk in I will just say “aagh sorry
10 but I cannot assist you in handling..., in taking your payment” from that perspective.

Now again one can say “but you must regulate against it” and then again I say “but how are you going to police it” from that perspective et cetera, et cetera. And it will drive the perception that people on the outside have that you got to bank with a large bank, which is totally what we do not want.

We want them to say “no, but we are willing to bank with smaller banks also to an
20 extent, because we know the system as it is will protect us if something goes wrong

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from that perspective,” and that is what we are trying with all our regulatory environment and whatever we do with we are trying to achieve from that perspective.

MR BODIBE: Okay, I was not asking the question to then make the leap to justify sorting-at-source, I was merely trying to understand that if it is on-us therefore it is the obligations of people who bank in the same institution and the role of the bank there is really to mitigate the risk, simply to say, to verify whether the one party has the adequate resources to pay the other party.

10

Is that not what on-us transactions involve and is that not why therefore that those type of transactions could then be seen later on than in real-time by the Reserve Bank, because the bank at that particular time is performing a function. In an inter bank relationship the Reserve Bank will want to see how the obligations to each other is being managed.

MR PIENAAR: Yes to an extent you are right and to an extent again I say, if we take sort-at-source to its logical conclusion there is liquid assets that the bank must keep et cetera, et cetera. Credential requirements, certain credential requirements.

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That particular assets is currently used within SAMOS to facilitate the flow of money and I think at some stage, the very first presentation said that it has turned around 98 times, that that particular values that the banks do keep, are turned around 98 times in a day.

10 Now again if you do not have clearing, you only have on-us transactions, what is telling the Reserve Bank that that bank still has got its prudential requirements liquidity paper et cetera, et cetera? There really is nothing that you can see that it is there, so it maybe a bank that goes into difficulty, may sell that particular prudential assets and not keep it and then when the pawpaw really hits the fan there is nothing to fall back on.

Whilst utilising it in the SAMOS and in the clearing environment, we actually monitoring it on a daily basis whether it is there, whether it is available et cetera. So that is why I still perceive that we should try and keep it on that basis.

20 MR BODIBE: But in that situation however that bank does not have obligation to other banks.

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MR PIENAAR: No but he certainly...

MR BODIBE: In on-us transactions.

MR PIENAAR: But he certainly has obligations to consumers. He certainly has got deposits that he needs to repay and if he has not got it who is going to stand behind him from that perspective. We do not have depository insurance currently in South Africa. So you are back to the Reserve Bank to either make him a loan or, against
10 what I do not know, and if they cannot, then it has got to go to Treasury who needs to take a decision whether they want to keep this bank afloat or not.

MR BODIBE: But if you were to focus narrowly on the issue of obligations of one customer to the other...

MR PIENAAR: Yes.

MR BODIBE: In that particular situation, it is the role of the bank to make sure that
20 each of his customers can stand good for the payment.

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MR PIENAAR: No, that is quite true but what one should also remember is that that particular deposits is not there anymore because the bank has put it out on the money market or he has lent it out to somebody else. So it is a book entry that happens there from that perspective, but you are correct.

10 ADV PETERSEN: Just on the latter point in your paragraph 3.8.1, you say, I do not think this is confidential, banks in the PCH select one of five options on how failure will be dealt with. The options range from the SARB proactively managing the situation to each participant contributing to any shortfall to ensure settlement. Ms Nyasulu pursued that angle in an earlier discussion. Currently, I continue to quote, “all PCH PGs that is participant groups, have selected the option that relays on the SARB timeously identifying a problem bank as part of its regulatory oversight of the settlement within the NPS through its bank supervision department and then to manage the bank out of the NPS if required, thus reducing shocks to other participants.

20 MR PIENAAR: That is correct, yes.

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ADV PETERSEN: I am not sure whether you want to answer this or not but is it PASA's experience that in fact the SARB does monitor banks in such a vigorous way that it can timeously identify a problem bank and manage it out of the NPS?

MR PIENAAR: Yes absolutely.

ADV PETERSEN: Well has that been the experience when banks have failed in recent years?

10

MR PIENAAR: Yes.

MR COETZEE: And can I also add, if transactions are off-us, the SARB is in a position to monitor on almost a real-time basis or a daily basis what these exposures are and to make an informed decision with respect to this clause. If those transactions are moving to on-us the SARB will not be in a position to monitor the liquidity and exposure of the bank.

20

ADV PETERSEN: Now again, this is just the purpose of being technically accurate, my understanding is that sorting-at-source is not prohibited currently by any statutory

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provision but that there are provisions in the PCH agreements and clearing rules which prohibited it, is that so?

MR COETZEE: Yes.

MR PIENAAR: Yes.

ADV PETERSEN: Now if sorting-at-source were to be prohibited or regulated at a statutory level including subordinate legislation, regulation and so forth that itself
10 would be quite complicated. I mean the prohibition is itself complicated, is it not?

MR PIENAAR: Yes it is true because if you want to police it, you have to look at the transactions that flow to the banks and that is the..., that is I think why the banks are so averse to allowing transactions to flow directly to the inner circle, the PCH system operator, because they say they do not have the capacity to monitor that particular customers or clients view from that perspective, whatever he inputs whether he only inputs his own transactions, whether he inputs at least a mix of
20 transactions et cetera, et cetera. So in that case if it goes to the operator they will have to rely on the operator to do those particular checks for them.

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ADV PETERSEN: Currently there are partial exceptions are they not where sorting-at-source are concerned?

MR PIENAAR: Yes certainly there are and I would like to point out that it is again probably due to the size of the banks. The business legs of the banks that is not always aware of the requirements and the risks that may arise and which then lure clients into doing that particular method of banking...

10 **Portion of proceeding not recorded due to equipment malfunction**

MR COETZEE: ...new Sort at Source arrangements.

ADV PETERSEN: You would appreciate that once again we are having to look at something which appears to be very much discretionary in the way that it is actually operated.

MR PIENAAR: Yes.

20 ADV PETERSEN: Would you agree that that may well be unsatisfactory?

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MR PIENAAR: Yes with my hat on it says I need a level playing fields certainly.

ADV PETERSEN: Could we engage with you in due course in the further conduct of this Enquiry to explore the details of that?

MR COETZEE: Yes.

ADV PETERSEN: Now on the side of the regulatory oversight, the position papers and the directives, I want to ask you just a couple of questions. In paragraph 7.4 of your submission, you deal with what you call “a transaction concentrator.” If I may quote:

“In some cases clients may use the services of the PSP/transaction concentrator that aggregate their transactions and send on to the acquiring bank.”

But this is not sorting- at-source, this involves an acquiring bank but an aggregation of transactions. You continue:

“The possible risks introduced by PSP/transaction

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concentrator or the payment beneficiary are not currently managed within the NPS regulatory framework.”

Are you aware of any directive or draft directive being prepared to address this particular matter?

MR COETZEE: Yes.

MR PIENAAR: Yes there is actually I think, I do not know how many it will be now
10 but there is..., the Reserve Bank is busy with one, two, three which I can remember of, whether they combine it I do not know. One specifically handling about system operators, which will include those people and then on third party payments, beneficiary payments, service providers and payment service providers.

MR COETZEE: There will be two positions..., directives.

ADV PETERSEN: We are..., we have been aware at least of the draft directive on
20 payments to third persons.

MR PIENAAR: Yes.

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ADV PETERSEN: Which is intended in particular, to address the risks which you and others have identified where a bureau is allowed to pool customers funds...

MR PIENAAR: Yes...

ADV PETERSEN: Into its, lets say the Bureau's own account.

MR PIENAAR: Yes.

10 ADV PETERSEN: Do you have a view and if so, are you prepared to express it as to whether the approach being taken in the draft directive really comes to grips with the management of risk?

MR PIENAAR: I must say I have not seen the latest words of the directives so it will be incorrect for me to comment at this point in time.

ADV PETERSEN: Then finally I am not sure that I heard this correctly but I think Mr. Coetzee in your opening statement you made mention to some provisions in the
20 PCH agreements and or all the clearing rules, having been identified which could well give rise to competition concerns...

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MR COETZEE: Yes...

ADV PETERSEN: Could you just helped me, where have you identified those?

MR COETZEE: We have prepared a CC7 and attached to the CC7 we have identified those rules. As I have also stated, we have highlighted in the clearing rules provided to you.

10 ADV PETERSEN: I do not mean confidentially concerns, I..., perhaps that is what you said.

MR PIENAAR: Yes.

ADV PETERSEN: Okay I thought you had said competition concerns.

MR PIENAAR: No.

20 ADV PETERSEN: Have you identified any PCH or are you able to identify any clauses of PCH agreements or clearing rules which in your experience or in your

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opinion give rise to competition concerns which we ought to be addressing that we have not yet raised with you?

(Caucus)

MR COETZEE: Mr. Petersen we identified sometime ago that the provisions in the PCH agreements pertaining to sorting-at-source might be anticompetitive or might result in such behaviour. At that stage that was at the end of last year when we referred it to our legal committee, PASA legal committee and it was agreed at that point in time by PASA council and the legal committee that we would rather await the outcome of the Competition Commission investigations and discuss with the SARB how we will take this forward. So sort-at-source was definitely one of those issues.

MR PIENAAR: That is the only one.

ADV PETERSEN: Provisions concerning direct switching to the issuer could also be considered in that context, could they?

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MR COETZEE: Yes more in the same context then possibly, yes, but...

ADV PETERSEN: The difference being there that the switch would be involved so it is not the extreme case of sorting-at-source that you have sketched.

MR PIENAAR: Mr. Petersen can I may be comment, I think if you are looking in context of which the PCH agreement was written, and sorry I know you cannot work on contents or content or intent at that point in time, I think the basis was that we just
10 tried to formalize between the banks something which was never there in the past, it was really based on trust, but it was handled.

So it never came into our mind, and I am quite honest about it personally from my side, to look at it from a competition perspective *per se* and say “but this is anticompetitive” because at the end of the day the members is prescribed through the Act, which are eligible to be there, so there is not really to my mind an issue that one can create between those members which is within this PCHs an issue of
20 competition.

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Specifically if you think about it that anyone becoming a member of PASA can enter into any of the PCH's under that rules as we have set it up from that perspective. So I think from that perspective we never really thought about the Competition Act *per se* at that point in time.

ADV PETERSEN: You will appreciate that in my question is not simply the legal issue of whether there is compliance or contravention involved but the policy issue...

10 MR PIENAAR: Yes...

ADV PETERSEN: Of the need to promote competition.

MR PIENAAR: Yes.

ADV PETERSEN: I take it that you are addressing both those aspects in the answer that you have just given me.

MR PIENAAR: Yes.

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ADV PETERSEN: I thought that was my last question but if I may.... just one more and I apologise if I have asked you this previously, because if I have I have not understood the answer. Why does one have both a RTC PCH and an immediate settlement PCH, why are they not rolled into one?

MR PIENAAR: It is quite..., it is actually quite easy. The RTC PCH is..., has been created to handle a low value payments with large volumes in mind.

10 ADV PETERSEN: With settlement occurring in the normal way, later?

MR PIENAAR: Settlement occurring later yes, whilst the other one settles immediately every time. You can actually transfer money, a low value amounts of money through it but obviously it is more costly than the RCT will be from that perspective because you use your liquidity for a R10,00 or a R20,00 transaction whilst you actually need it for the..., above five million type transactions.

ADV PETERSEN: Thank you.

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CHAIRPERSON: Thank you Mr. Coetzee and the team, thank you very much for your presentation.

MR COETZEE: Thank you Mr. Chair.

CHAIRPERSON: The Enquiry will then adjourn to the...

MS NYASULU: The 9th...

10 CHAIRPERSON: Until 9 July 2007 at 09:30 am. Thank you.

(End of proceedings)

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